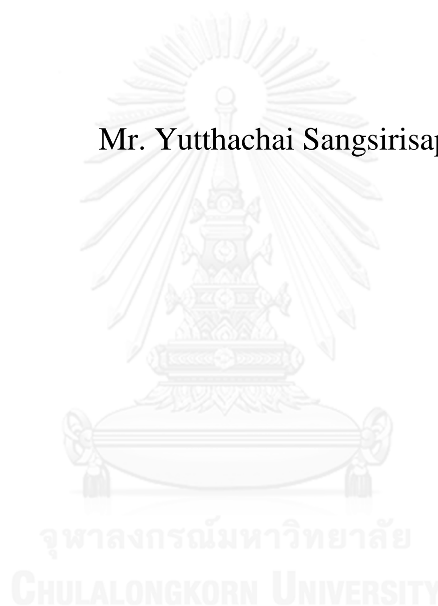
Legal measures relating to supervision and roles of hedge fund manager in Thailand

Mr. Yutthachai Sangsirisap



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มาตรการทางกฎหมายในการกำกับดูแลและบทบาทของผู้จัดการกองทุนเฮดจ์ฟันด์ในประเทศไทย

นายยุทธชัย แสงสิริทรัพย์

วิทยานิพนธ์นี้เป็นส่วนหนึ่งของการศึกษาตามหลักสูตรปริญญานิติศาสตรมหาบัณฑิต
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Thesis Title	Legal measures relating to supervision and roles of hedge fund manager in Thailand
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ยุทธชัย แสงสิริทรัพย์ : มาตรการทางกฎหมายในการกำกับดูแลและบทบาทของผู้จัดการกองทุนเฮดจ์ฟันด์ในประเทศไทย (Legal measures relating to supervision and roles of hedge fund manager in Thailand) อ.ที่ปรึกษาวิทยานิพนธ์หลัก: อ. ดร. พัฒนาพร โกวพัฒนกิจ, 155 หน้า.

วิทยานิพนธ์เล่มนี้มีวัตถุประสงค์เพื่อศึกษาการกำกับดูแลและบทบาทหน้าที่ของผู้จัดการกองทุนเฮดจ์ฟัน โดยศึกษาจากกฎหมายต่างประเทศ เพื่อสร้างความเข้าใจที่ถูกต้องเกี่ยวกับความรับผิดชอบของผู้จัดการกองทุนเฮดจ์ฟัน และเพื่อเป็นการช่วยสนับสนุนการเติบโตของระบบการเงินของไทย

ผู้วิจัยได้ทำการศึกษากฎหมายต่างประเทศสามประเทศด้วยกัน อันได้แก่ สหรัฐอเมริกา สหราชอาณาจักร และ ประเทศเกาหลีใต้ เพื่อเปรียบเทียบ พัฒนาการทางกฎหมายของผู้จัดการกองทุนเฮดจ์ฟัน โดยพบว่าการกำกับดูแลผู้จัดการกองทุนเฮดจ์ฟัน นั้นได้มีการพัฒนาจากเดิม นอกจากนี้ผู้จัดการกองทุนเฮดจ์ฟันถูกจัดประเภทเช่นเดียวกันกับผู้จัดการกองทุนรวมซึ่งส่งผลให้มีการกำกับดูแลที่คล้ายคลึงกัน นอกจากนั้นผู้จัดการกองทุนเฮดจ์ฟันอาจกระทำการฉ้อโกงนักลงทุนหรือตกอยู่ในสถานการณ์ที่อาจจะมีผลประโยชน์ทับซ้อนกับนักลงทุน แต่อย่างไรก็ดีประเทศไทยยังไม่มีกฎเกณฑ์ที่ใช้สำหรับผู้จัดการกองทุนเฮดจ์ฟัน อย่างไรก็ตามจากการศึกษาพบว่าผู้จัดการกองทุนเฮดจ์ฟันและผู้จัดการกองทุนรวมนั้นมีความคล้ายคลึงกันในด้านการปฏิบัติหน้าที่ ดังนั้นในแง่ของการกำกับดูแลก็ควรจะกำกับไปในทิศทางเดียวกัน และเมื่อผู้จัดการกองทุนเฮดจ์ฟันถูกกำกับดูแล ผู้จัดการกองทุนเฮดจ์ฟันจะถูกบังคับให้ปฏิบัติตามข้อบังคับเพื่อปกป้องนักลงทุนและเพื่อประโยชน์สาธารณะ

ด้วยเหตุนี้เองจึงมีความจำเป็นที่จะต้องนำมาตรการทางกฎหมายในส่วนที่เกี่ยวข้องกับกฎหมายหลักทรัพย์มาปรับใช้การให้ใบอนุญาตผู้จัดการกองทุนและคุณสมบัติของนักลงทุนในกองทุนเฮดจ์ฟัน เพื่อเป็นการสนับสนุนการเติบโตของอุตสาหกรรมกองทุนเฮดจ์ฟันในเอเชีย และเพื่อเป็นการปกป้องนักลงทุนชาวไทย

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สาขาวิชา กฎหมายธุรกิจ ลายมือชื่อนิสิต ....

ปีการศึกษา 2558 ลายมือชื่อ อ.ที่ปรึกษาหลัก ....

5686360034 : MAJOR BUSINESS LAW
KEYWORDS: HEDGE FUND

YUTTHACHAI SANGSIRISAP: Legal measures relating to supervision and roles of hedge fund manager in Thailand. ADVISOR: LECTURER DR. PATANAPORN KOWPATANAKIT, 155 pp.

The objective of this thesis was to study supervision and roles of hedge fund managers from foreign law in order to ensure appropriate perceptions of their responsibilities and help sustain growth in the Thai financial system.

The researcher examined the relevant laws in three foreign nations including the United States (US), United Kingdom (UK), and South Korea to compare the legal development of hedge fund managers. The results found that the supervision of hedge fund managers developed from the beginning. Additionally, a hedge fund manager's role falls into the same category as a mutual fund manager, which means it involves similar regulatory oversight. Moreover, a hedge fund manager may commit fraud against investors or get involved in situations where conflict of interest may affect the interests of investors. Unfortunately, there are no regulations for hedge fund managers in Thailand. However, both hedge fund managers and mutual fund managers have similarities in the substance of their roles. As such, both should be regulated similarly in term of regulatory oversight. Once the activities of hedge fund managers are regulated, they are obligated to comply with certain rules designed to protect investors as well as the public interest.

Hence, it is necessary to adopt and adjust some legal measures concerning securities regulation, fund management licensing and investor qualifications for a hedge fund manager to support the growth of the hedge fund industry in Asia and protect Thai investors.

Field of Study: Business Law	Student's Signature ....
Academic Year: 2015	Advisor's Signature ....

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I owe a lot to them in many ways; they dedicated their valuable time and energy toward the fulfillment of the requirements for this thesis. Without their help, it could not have been completed.

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Chapter 1

Introduction

1.1 Background

In recent years, the financial industry has grown enormously. This is especially true for the hedge funds industry. The hedge fund plays a critical role in the global financial industry. The size of assets under management by a hedge fund was about 2.38 trillion USD as of Quarter 3 in 2014. [1] This massive amount of money is spread thoughout the global financial market and affects it national financial markets in many ways.

There is no legal definition for a hedge fund, but the first was established in the U.S. in 1949.[2] [3]The name "hedge fund" refers to hedging techniques, which are used to protect loss from fluctuation with short and long strategies on one security against other securities to compensate for the loss. This way, the portfolio will lock in gains equivalent to the risk-free rate of interest. However, it has changed in the present day to be a highly speculative fund. They use various financial instruments to maximize investor returns and eliminate as much risk as possible. As such, the investment purpose of a hedge fund has changed from the past and is focused on making as much money as possible regardless of market conditions.[4]

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[1] Barclayhedge, "Hedge fund Assets Under Management", [online] available from: http://www.barclayhedge.com/research/indices/ghs/mum/HF_Money_Under_Management.html [2015,January 13]

[2] Vikrant Singh Negi, "Legal Framework for Hedge Fund Regulation" [online] available from: http://www.hedgefund-index.com/Legal%20Framework%20for%20Hedge%20Fund%20Regulation.pdf [2015,August 19]

[3] Filippo Stefanini, "Investment Strategies of Hedge funds" Page3.

[4] David A. Vaughan, "Comments for the U.S. Securities and Exchange Commission Roundtable on Hedge Funds", [online] available from: https://www.sec.gov/spotlight/hedgefunds/hedge-vaughn.htm

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A hedge fund and mutual fund have various similarities. They are both investment vehicles which collect money from many people into a large fund, which is then managed by the fund manager. On the other hand, there are many differences between them as well. For example, a hedge fund manager has more flexibility in management than a mutual fund manager because the objective of hedge fund investment is focused on absolute returns regardless of market conditions. On the other hand, most mutual funds focus on relative returns. Hence, a hedge fund manager has the ability to invest in any type of assets with no proportion of investment, while a mutual fund's investment is regulated by oversight. Thus, a mutual fund manager has to make investments under a controlled and compliance framework. Because the investment objective of a hedge fund focuses on absolute returns, it uses more aggressive strategies than a mutual fund. Typically, a hedge fund relies on speculative investment strategies and focuses on derivative securities as well as various financial instruments. On the other hand, a mutual fund is not allowed to make a speculative investment and restricted to investment in derivative securities only for diversification. Also, a hedge fund is only available to specific types of investors or qualified investors, who are generally wealthy investors able to shoulder the financial risk and capable of fending for themselves. By contrast, mutual fund investors are mostly unsophisticated investors who have less experience and knowledge about investment. Generally, a mutual fund investor can be anyone who is willing to invest in a mutual fund. In conclusion, a hedge fund is a fund that develops from a mutual fund but has more investment potential than a mutual fund. As such, it gets rid of many investment barriers to satisfy investors' needs, which in turn creates more investment opportunities.

A hedge fund used to be an unregulated or lightly regulated investment vehicle. In the past, regulators provided several exemptions for hedge funds and hedge fund managers, which offered investment flexibility for both fund and manager. Because hedge fund investors tend to be sophisticated, they are able to protect themselves from financial loss. Also, a hedge fund is an alternative investment vehicle; the manager has the flexibility to avoid some regulatory requirements by changing the form of the fund to qualify, such as for exemption requirements. Nevertheless, such damage and loss is wide spread for both investors and the financial market after considering the loss and

damage caused by a hedge fund and hedge fund manager. According to the number of fraud cases caused by hedge fund managers and the cause of the financial crisis in 2008, there are opinions concerning placement of the hedge fund and hedge fund manager under the oversight of authorities, who can oversee their business closely and may be able to prevent such financial damage before it occurs. As a result, U.S. regulators enacted a law in 2010 called the "Dodd–Frank Wall Street Reform and Consumer Protection Act." The purpose of this regulation focused on the hedge fund business by requiring hedge funds and hedge fund managers to comply with several regulatory requirements to ensure that the investors are protected and prevent future systematic risk.[5] [6]

In the present day, a hedge fund does not operate only within the U.S., but has spread all around the world, particularly in Asia. Countries such as Japan, Hong Kong, Singapore, and South Korea have hedge funds because of the growth of the financial market in Asia. In recent years, the hedge fund market has been expanding rapidly in Asia; from 2013 to 2014, the industry accumulated an additional $33 billion in capital, a 29% growth over the 12 month period ending 31 December 2014.[7] According to those numbers, many countries in Asia tend to prefer hedge funds to be established in their own country to prevent capital outflow. From the facts illustrated, Thailand cannot avoid the hedge fund business in the future, whether directly or indirectly.

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The Thai SEC is currently in the process of hearing arguments to ease the investment restrictions on mutual funds. New investment flexibility would allow a mutual fund to make an investment without any restriction. Under the new proposal, the fund would be categorized similarly to a mutual fund. Meanwhile, the fund would only be available for a specific type of investor, such as an institutional investor and Ultra High net worth investor, due to its risk and complexity. Compared to foreign

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[5] Kimberly Amadeo, "What are hedge fund?" [online] available from: http://useconomy.about.com/od/themarkets/f/hedge_funds.htm

[6] Rob Curran, "Hedge fund regulation? What hedge fund regulation?" [online] available from: http://fortune.com/2011/06/14/hedge-fund-regulation-what-hedge-fund-regulation/

[7] Value Walk, "Asia-Pacific Hedge Funds Grow By Almost 30% In 2014" [online] available from: http://www.valuewalk.com/2015/03/asia-pacific-hedge-funds-grow-by-almost-30-in-2014/

countries, the fund has some similarities and differences with a foreign hedge fund in terms of each investor possessing high net worth or institutional support.[8]

Hedge funds themselves are not illegal; they are simply a vehicle that facilitates fraudulent activity committed by hedge fund managers. However, the amount of money involved and financial market stability, as well as the lack of regulatory oversight, could cause many problems for investors and securities market. [9] Normally, a hedge fund manager trades with a large sum of money based on information received each day, so it is hard for the authorities to detect and investigate fund activities such as market manipulation or attempts to dominate the market because of the trade order amounts. Furthermore, a hedge fund manager trades on information received daily, so he/she might engage in various activities such as market manipulation, money laundering or any other prohibited transactions. These transactions are difficult to detect and also hard to investigate because all information such as trading orders and other transactions are kept private. [10] Also, the authorities have to ask for such information from the third parties who are doing business with a hedge fund manager; such a process might take a long time and is complicated. Moreover, a hedge fund manager has the ability to use leverage to maximize a fund's performance. Such leverage can create an enormous problem in the financial market and might lead to a financial crisis. However, the authorities can set a proper leverage ratio policy regarding the financial situation if they know the amount of a hedge fund and leverage ratio.[11] Also, a hedge fund manager is

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[8] The Publications of the Thai Securities and Exchange Commission, "The easing investment restrictions of the mutual fund that offered to accredited investor" (อกน.19/2558)

[9] Becky Yerak, "Chicago money manager Stephen Coleman charged with fraud", Chicago Tribune, [online] available from: http://articles.chicagotribune.com/2014-05-23/business/chi-stephen-coleman-20140523_1_deuce-securities-laws-money-manager

[10] Greg Jones, Kevin Lenaghan, Daniel Stern, Jonathan Weinstein, "Hedge Funds and High Frequency Trading" [online] available from: https://www.virtus.com/vsitemanager/Upload/Docs/CW_HedgeFundsandHighFrequencyTrading_6681.pdf

[11] JPMorgan, "Leveraging the Leverage Ratio" [online] available from: https://www.jpmorgan.com/cm/BlobServer/is_leveragingtheleverage.pdf?blobkey=id&blobwhere=132

in a position that makes it possible to commit fraud by sending a false statement, a misleading or any untrue statement, to get money from investors unlawfully.[12] The problem of fraud committed by a hedge fund manager is one of the top problems; it directly affects an investor's reliability. Thus, it is necessary for the authorities to create tools and sources of data to detect and track a fund's activities.

Second, transparency and disclosure are important elements in the fund business, because they allow both parties to understand the nature of the deal and be able to evaluate the risks and profit. As a hedge fund manager gets involved in highly complicated transactions, providing necessary disclosure and transparency to investors and authorities would be beneficial to both investors and authorities because investors can make informed decisions and the authorities can monitor potential fraud.[13]

Moreover, a hedge fund manager does not require the provision of reliable information for investors, so that might cause a fund transparency problem. Lack of transparency can expose investors to a rising level of risk without sufficient warning because investors will never know whether or not the hedge fund manager is following the fund's stated strategies. Sometimes, a hedge fund manager may drift away from an earlier statement. It is difficult for investors to estimate risk on investment trends. Furthermore, hedge fund manager often have a stake in fund transactions, thereby putting their own interests ahead of an investor's interest. Providing detailed information about the nature of a fund's investments, manager's compensation, liabilities, and overhead costs would provide more transparency for investors and reduce the fraudulent transactions that harm investors. [14]

0634324649&blobheader=application/pdf&blobheadername1=Cache-Control&blobheadervalue1=private&blobcol=urldata&blobtable=MungoBlobs

[12] The Federal Bureau of Investigation, "Hedge fund Information for Investors" [online] available from: https://www.fbi.gov/about-us/investigate/white_collar/hedge-fund-fraud

[13] "Hedge Fund Transparency" [online] available from: http://www.hedgefundmarketing.org/hedge-fund-transparency/

[14] Kevin Doran, "Guidelines for Disclosure & Transparency" [online] available from: http://smallbusiness.chron.com/guidelines-disclosure-transparency-private-equity-67996.html

Third, a hedge fund manager is prohibited from advertising. This restriction is intended to prevent a potentially fraudulent offer or marketing their services to ineligible or inappropriate investors. A hedge fund manager has a powerful incentive to seek more investors, because a typical fee amounts to two per cent of the asset under management and twenty percent of any profit. Thus, the more investors there are, the higher the income.[15] A hedge funds manager offers securities on private placements basis or individual basis rather than through public advertising due to the restriction. Nevertheless, such communication and information between hedge fund manager and investors is not reviewed by the authorities, so there is a lack of reliable information. In practice, a hedge fund manager and a fund's interest have to register before being introduced or offered to their investors; the authorities approve all information and ensure that the information being disseminated by the hedge fund is accurate. Furthermore, a hedge fund manager can only engage qualified investors because the manager can only take money from "accredited investors", which means wealthy people. Thus, a hedge fund manager cannot make a general solicitation or publicly introduce their fund. Those prohibitions also include public speaking or interviews that mention the fund.[16] [17]

Nevertheless, considering the roles and duties of a hedge fund manager and mutual fund manager finds that both of them have several similarities. First, both are funds managers who have a responsibility to manage a fund and make decisions on investments. Also, they have duties to investors and authorities to disclose all necessary information to investors in order to provide transparency. The most important thing is that both a hedge fund manager and mutual fund manager are the ones with the responsibility for investors' money. However, the Thai Securities Regulation states that

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[15] Harvey D. Shapiro, "Why aren't Hedge Fund Advertising?" [online] available from: http://www.newyorker.com/business/currency/why-arent-hedge-funds-advertising

[16] "Hedge Fund Sales and Marketing" [online] available from: http://www.hedgefundmarketing.org/hedge-fund-sales-and-marketing/

[17] Victor L. Zimmermann, Jr, "Hedge Fund Marketing: Pros, Cons and Structuring Agreements with Third-party Marketers" [online] available from: http://www.intercontilimited.com/mfutsarchive/hedge_fund_marketing.pdf

there is no regulation to apply to a hedge fund and a hedge fund manager. Nonetheless, the roles and responsibilities of a hedge fund manager are similar to a mutual fund manager. According to foreign law, both a hedge fund manager and mutual fund manager are regulated similarly, except for some exemptions provided for a hedge fund manager. Generally, hedge fund managers and mutual fund managers in foreign countries are subjected to similar regulations.[18] Hence, lifting the regulatory standard on a hedge fund and a hedge fund manager is reasonable, meaning to categorize a hedge fund manager as a fund manager and apply some part of those regulations to a hedge fund manager. To prevent financial crime caused by a hedge fund manager, it is necessary to regulate the manager in a similar way as a mutual fund manager, which will lead to better tools to detect and investigate fund transactions.

As a result, this thesis studies the background and development of legal measures, the role, and supervision of a hedge fund manager and a mutual fund manager, as well as the legal measures used by a hedge fund manager in foreign countries. It alo compares the mutual fund manager's regulation to understand and compare the roles and legal measures between a hedge fund manager and a mutual fund manager in Thailand. Because a hedge fund manager and a mutual fund manager have similar duties, it is reasonable to adopt some part of the mutual fund manager's regulation for a hedge fund manager to provide proper legal measures for hedge fund management in Thailand.

1.2 Thesis Hypothesis

A hedge fund manager plays significant roles in the fund and financial markets, which may lead to operational risk. However, Thailand has no regulations that are applied in hedge fund management. Nevertheless, both hedge fund manager and mutual fund manager have similarities in terms of their roles and responsibilities in fund management. Hence, it is necessary to adopt some part of a mutual fund manager's regulations to hedge fund management.

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[18] U.S. Securities and Exchange Commission, "Regulation of Investment Advisers" [online] available from: http://www.sec.gov/about/offices/oia/oia_investman/rplaze-042012.pdf

1.3 Thesis Objective

1. Study and understand the roles and duties of a hedge fund manager.
2. Study and understand the laws and regulations relating to a hedge fund manager.
3. Study and understand the problems that may arise regarding the roles and supervision of a hedge fund manager in Thailand as well as in foreign countries.
4. Study and understand the legal principles used to regulate a hedge fund manager in foreign countries, also the possibility and suitability of adoption and the consequences.

1.4 Thesis Scope

Study the roles and duties of a hedge fund manager and regulatory oversight.

1.5 Thesis Procedures

In the present, both hedge fund managers and mutual fund managers are regulated similarly. Moreover, the two biggest hedge fund businesses are located in the U.S. and U.K., which have the most developed hedge fund regulations. Thus, this thesis will mainly use information based on the U.S. and U.K. regulation, as well as a documentary research method which consists of a following:

- Financial and investment textbooks
- Related research
- Newspaper articles
- Investment magazines
- Articles which relate to hedge funds
- Websites

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1.6 Benefits of the Thesis

1. Understand the impact and mechanism of the hedge fund business
2. Understand the legal principles which relate hedge fund management in Thailand and foreign countries.
3. Understand and forecast future problems under the roles and supervision of a hedge fund manager
4. Understand the legal principles used to regulate a hedge fund manager and the appropriate solutions for Thailand

Chapter 2

The Supervision and Roles of a Hedge Fund Manager

2.1 Background

The term "hedge fund" does not appear to be defined anywhere, even by U.S. federal securities laws. There is no single definition for the phrase that seems to be used by industry participants. However, we can describe a hedge fund as "any pooled investment vehicle that is privately organized, administered by the professional investment manager, and not widely available to the public".[19]

A hedge fund manager has the most important role in a hedge fund because a hedge fund manager is the person responsible for managing the fund and makes the decisions about investments. Historically, a hedge fund manager is not required to register under the Investment Adviser Act of 1940 because of the private adviser exemption. As such, hedge fund managers can avoid registration. However, hedge funds played an important role in the financial market during the financial crisis in 2008 because they held about 47 percent of the $3 trillion worth of CDOs.[20] [21] During that time, the standard risk measurement methods were not substantial and underestimated the threat of a hedge fund in the financial market, which resulted in minimal regulatory oversight.

Furthermore, the issue of a hedge fund manager also raised concerns according to the number of cases where investors sued a hedge fund manager, not the hedge fund itself. Normally, hedge funds are not illegal; they are investment vehicles that facilitate

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[19] Kathleen Ann Ruane, Michael V. Seitzinger, "Hedge Funds: Legal History and the Dodd-Frank Act", Congressional Research Service.

[20] Photis Lysandrou, "The real role of hedge funds in the crisis" [online] available at: http://www.ft.com/intl/cms/s/0/e83f9c52-6910-11e1-9931-00144feabdc0.html#axzz3Q2zX1xhx

[21] CDO (Collateralized Debt Obligations) mean a structured financial product which pools a cash flow-generating assets especially a loan and repackages together and then sale to investors on the secondary market. See. Kimberly Amadeo, "CDOs (Collateralized Debt Obligations)" [online] available from: http://useconomy.about.com/od/glossary/g/CDOs.htm

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financial crime activities committed by managers. The U.S. SEC has investigated a variety of fraud cases involving hedge funds run by hedge fund managers. For example, the investors may receive false financial statements stating that the fund makes a substantial profit when, in fact, the fund suffers huge losses or the money was being siphoned off and used to finance the manager's lavish lifestyle. As a result, the hedge fund manager may issue false financial statements to fool investors and hide the losses or missing money.[22]

As a consequence, the U.S. SEC has concerns about hedge funds and hedge fund managers. Accordingly, they enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act, as well as subjected hedge fund managers as investment advisers, which will expand the scope of oversight on a hedge fund and hedge fund manager as well as move up the standard of risk measurement. It also required a hedge fund manager to register with the SEC. The SEC believed that registration might prevent fraud and other issues because the SEC would have better oversight of hedge fund management.[23] Furthermore, the registration would provide the SEC with accurate information and take less time for investigation.[24]

2.1.1 Brief history of hedge fund

Alfred Winslow Jones, a former reporter for Fortune, started the very first hedge fund in 1949 with initial capital of only $ 100,000. He combined two analytical techniques, i.e. using both short sales and leverage. This method made it possible to reduce total portfolio risk and construct a conservative portfolio, featuring a low exposure to the general market performance. After that, his profit came from a 20% stake in generated performance rather than from payment of the fixed percentage of

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[22] Federal Bureau of Investigation, “Hedge fund information for investors” [online] available at: http://www.fbi.gov/about-us/investigate/white_collar/hedge-fund-fraud

[23] Willian K. Sjostrom, Jr. “A brief history of hedge fund adviser registration and its Consequences for Private Equity and Venture Capital Advisers” Harvard Business Law Review.

[24] Donna Rodgers, “The Dodd-Frank Act Requires Hedge Fund Investment In Compliance and technology” [online] available at: http://financialservices.about.com/od/EthicsCompliance/a/The-Dodd-Frank-Act-Requires-Hedge-Fund-Investments-In-Compliance-And-Technology.htm

assets under management. As a result, he found that it was possible to bring the interests of the manager and investors together.[25]

Later, many hedge funds were launched. However, the strategies began moving away from Jones' model and into one that mainly used leverage methods rather than choosing stocks and hedging them against risk.

A hedge fund in the present day has come far from the original model. After the development of financial institutions and markets, the new financial instruments such as listed and over-the-counter derivatives have appeared, which improved efficiency by allocating risk to those most willing to accept it. Nevertheless, growth of the hedge fund has accelerated dramatically over the last decade, in both assets under management and the number of funds. Although precise figures are difficult to obtain, recent industry reports estimate that there are now between 8,000 to 10,000 hedge funds worldwide, managing a total wealth of more than a trillion dollar.[26]

2.1.2 History of hedge fund adviser registration

Historically, hedge fund managers were lightly regulated and also were not required to register with the U.S. SEC under the Investment Advisers Act of 1940[27] because of the private adviser exemption. First, the private adviser exemption was allowed for advisers who met the condition, including any advisers who had less than fifteen clients during the previous twelve months. Second, it did not publicly hold itself out as an investment adviser, and third, did not advise registered investment companies.[28] As a result, they were exempt from registration as long as the hedge fund manager kept the number of clients less than fifteen. Furthermore, hedge fund advisers always counted each fund as one client, not an individual investor in the fund.

[25] Filippo Stefanini "Investment Strategies of Hedge funds" Page 3.

[26] HFR Global Hedge Fund Industry Report: Mid-Fourth Quarter 2014 [online] available at : https://www.hedgefundresearch.com/?fuse=products-irglo

[27] See. Investment Advisers Act of 1940, 15 U.S.C. § 80b-1 to -21 (2006).

[28] See. Investment Advisers Act, § 203(b)(3), 15 U.S.C. § 80b-3(b)(3)

The Dodd-Frank Wall Street Reform and Consumer Protection Act passed in the wake of the global financial crisis in July 2010.[29] The aim was to prevent another significant financial crisis from occurring by creating new financial regulatory processes that enforced transparency and accountability. [30] This provision was reflected in several approaches; it adopted a look-through rule, where every hedge fund manager had to count each investor as one client and also deleted the private adviser exemption from the Investment Adviser Act.

Furthermore, registered advisers would be required to maintain records and file reports of much of the information-sharing process with the SEC so that the information would be available to other relevant regulators, including the Financial Services Oversight Council (FSOC).[31]

2.2 Definition of hedge fund

In recent years, the hedge fund has been defined in several ways because there is no legal or commonly accepted definition. Nevertheless, the word "hedge fund" can usually be defined as "an investment vehicle that pools the monetary contributions of multiple investors and employs a variety of investment strategies."[32] Moreover, some research refers to a hedge fund as "an entity that holds a pool of securities and perhaps other assets, whose interest are not sold in a registered public offering and which is not registered as an investment company under the Investment Company Act."[33]

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[29] Mayer Brown, "Understanding the New Financial Reform Legislation: The Dodd-Frank Wall Street Reform and Consumer Protection Act" [online] available at: http://www.mayerbrown.com/public_docs/Final-FSRE-Outline.pdf

[30] See. 15 U.S.C. § 780-7.

[31] The Dodd-Frank Act, Section 404.

[32] See. Technical Committee of the International Organization of Securities Commissions, Regulatory and Investor Protection Issues Arising from the Participation by Retail Investors in Hedge Funds, [online] available from: http://hb.betterregulation.com/external/IOSCO%20PD142.pdf

[33] See. "Implications of the Growth of Hedge Funds", Staff Report to the United States Securities and Exchange Commission. [online] available at: http://www.sec.gov/news/studies/hedgefunds0903.pdf

Also, a hedge fund was initially devised to (or "intending to") hedge the risks of portfolio management.[34] According to the purpose of the first hedge fund formed by Alfred W. Jones, who tried to create it as a low-risk private investment vehicle, there are various hedging techniques to insure the invested portfolio against any possible decrease in the price of any invested assets. Nonetheless, hedge funds have transformed over time into a highly speculative and risky investment vehicle. There have been attempts to invest in other financial instruments and engage in a wider variety of investment strategies as well.

2.3 Definition of "Hedge fund manager."

As mentioned earlier, hedge fund has no legal definition. The term for hedge fund manager also has no legal definition. A hedge fund manager takes the most important role in the fund and also has a series of duties. In the beginning, a hedge fund manager is the one who contacts each investor and solicits them to make an investment in a hedge fund. The manager also delivers information to investors. The hedge fund manager makes decisions about fund investment, selecting securities and making financial reports. A hedge fund manager will receive compensation or a fee in return for work. Nevertheless, after considering the role and duties of hedge fund manager, it is obvious that a hedge fund manager is in the best position to commit possible fraud or illegal activities because there is no authority to oversee their operations or transactions, which creates a series of problems. After the financial law reform in the U.S., hedge fund managers were subjected to the definition of an investment adviser. [35] Once hedge fund managers are subject to the law, they have to comply with the law and have duties to disclose and deliver information to both the public and authorities to protect investors and provide financial stability.

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[34] "Hedging" mean doing something to insure against potential loss or to mitigate the risk of loss.

[35] The U.S. Investment Adviser Act of 1940 Section 202(a) (11). Stated that "Investment adviser'' means any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities…"

2.4 Relationship between hedge fund manager and investors

A hedge fund is structured as a limited company having a hedge fund manager as a general partner responsible for the investment activities and operation of the fund. On the other hand, investors are shareholders who supply capital but cannot participate in fund management, trading, or operation of the fund. The investor, who is a shareholder, has a limited loss of their investment. By contrast, a hedge fund manager, who is a general partner, has unlimited liability and is also liable for every activity of the partnership.[36]

Usually, a hedge fund manager and investors together put their money into a pool of fund assets. The reason is that a hedge fund manager wants to ensure their investors that they will manage the fund in their best interest because the fund manager also puts his own money in it. So, this method allows a hedge fund manager and investors can share profit and loss together. As a result, the relationship between hedge fund manager and investors is as partners.

The relationship between a hedge fund manager and their investors does not stand on equal rights because a hedge fund manager has better access to fund information such as transactions and trading information. On the other hand, hedge fund investors only receive information from what the manager provides. For the most part, they have no right to require advanced information.[37]

2.5 Similarities and difference between hedge fund manager and mutual fund manager

Hedge funds and mutual funds are similar in the fact that they are both a pool of investment vehicles especially established for securities investment purposes. Moreover, both a hedge fund manager and mutual fund manager fall into the definition

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[36] Turn key hedge fund, Inc, "About Hedge funds", [online] available from: http://www.turnkeyhedgefunds.com/about_hedge_funds.htm

[37] Ibid.

of "investment adviser", as found in the U.S. Advisers Act Section 202(a) (11). [38] According to the definition of "investment advisers" it provides three elements that define both hedge fund manager and mutual fund manager, which are:

- Provides advice or issues reports or analyses to other concerning securities
- Such a person is in the business of providing those services
- Such a person provides those services for compensation

Normally, both hedge fund manager and mutual fund manager have similarities in terms of their responsibilities for investors and fund management. Hence, both a hedge fund manager and mutual fund manager are responsible for investors' money and making decisions on the securities or other assets to generate a good return as investment advisers. Furthermore, a fund manager has to provide a fund's performance statement and various other documents for investors. In terms of fund management, both managers have the same roles and responsibilities to their investors. As a result, they are regulated similarly in terms of oversight. For instance, both a hedge fund manager and mutual fund manager may require registration with the SEC, which allows the authorities to easily monitor and examine their activities. Also, both of them have to disclose information about themselves to inform every investor about material information and allow the authorities to examine that information. Also, they are subject to the same anti-fraud provisions, which prohibit them from committing fraud or other harmful activities against investors. Even though both a hedge fund manager and mutual fund manager have a common role, which results in the same regulatory oversight, there are some differences that require them to be regulated differently.[39]

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[38] The Investment Advisers Act defined "investment adviser" as: any person who, for compensation, engages in the business of advising others, either directly or through publications or writing, as to the value of securities or as to the advisability of investing in purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities….

[39] The U.S. Securities and Exchange Commission, "General Information on the Regulation of Investment Advisers" available from:
https://www.sec.gov/divisions/investment/iaregulation/memoia.htm

The objective of investment in a hedge fund and mutual fund are different. A mutual fund is available for everyone, whether wealthy or not, so every investor can engage in a mutual fund. Normally, mutual fund investors are individual investors who have less experience in finance and investment. Nevertheless, all investments involve risks, whether from an investment or fund manager. Sometimes, investors lose money on their investment, while other times the loss is caused by fraud or misstatement, which is committed by the fund manager. As a result, regulators want to provide market transparency and protect the public interest using a highly regulated mutual fund and mutual fund manager, which requires them to register with the authorities and disclose material information to the public, which ensures that each fund manager is within the authorities' oversight.

On the other hand, a hedge fund is subjected to the regulatory requirements designed to protect investors, similar to a mutual fund. Both a hedge fund manager and mutual fund manager are prohibited from committing fraud or any harmful activities against investors.[40]

Nonetheless, investment ability between a hedge fund and mutual fund are different. First, there is an investment restriction that limits the percentage or type of asset that a mutual fund can invest in. On the other hand, there is no investment restriction for a hedge fund. Thus, a hedge fund manager can invest in various kinds of assets without any limitation. However, a hedge fund's investment ability may involve risky investment strategies or assets.

Nevertheless, every investor in a hedge fund is a wealthy or sophisticated investor. These kinds of investors can fend for themselves from loss, and they also know about the investment risk. Furthermore, a highly-regulated hedge fund would create cost and time consumption for both the hedge fund and investor to get through the entire process because the hedge fund manager has to file an application form and take several processes to register the fund and himself with the authorities. Also, those wealthy and sophisticated investors should be able to request any information they need to assess the risk of investment. Compare this to a mutual fund investor, who is

[40] The Investment Advisers Act, Section 206.

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unwealthy and unsophisticated. Such investors are unable to request information from the fund manager; they have to rely on the information that the fund manager provides for them. Nevertheless, such information must be approved by authorities to ensure the accuracy and correctness of the information. As a result, investors need to be protected from fraud, misstatement, or any harmful activities.

Regulators do not ignore regulation of a hedge fund and hedge fund manager. Nowadays, hedge funds are a much bigger part of the market than they used to be. They may sell short as well as buy long; they are very aggressive in the marketplace, taking strong positions and moving money very quickly. They follow a herd mentality, as do most fund managers of any sort. When they all go long, the market rises. When they all go short, the market falls. They tend to go one way, then the next, and the market experiences violent shifts from day to day. Nonetheless, when the Long Term Credit Management crisis broke, it caught the Federal Reserve Bank's (Fed) attention because the Fed had not known about the developing problem until it happened. In the present, hedge fund activities are much more interconnected with the global financial system than before. When considering the impact that a hedge fund can pose on the financial market and global economics, the hedge fund can pose massive damage to the financial system. To avoid financial crises, the quality of the information available to the Government and regulators must be available for monitoring in order to prevent those activities.[41]

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As a result, a hedge fund and hedge fund manager are required to disclose and report a certain type of information such as leverage, balance sheet, trading position, and assets held by the authorities. The authorities will use that information to monitor and prevent any potential future risk posed by a hedge fund and hedge fund manager. By contrast, even a mutual fund has less investment ability than a hedge fund, but a mutual fund holds a large amount of capital. The financial institution is their client. If a mutual fund fails, the consequence is quite similar to a hedge fund failure.

[41] D. Quinn Mills, "The Problem with Hedge Funds", Harvard business school, [online] available from: http://hbswk.hbs.edu/item/the-problem-with-hedge-funds

Nonetheless, the frequency of reporting is different among countries depending on the size of the fund and the policy in each country.[42]

2.5.1 Regulatory oversight

Both a hedge fund manager and mutual fund manager have the same roles and responsibilities in the fund, whether making an investment decision or managing the fund. Both a hedge fund manager and mutual fund manager are usually responsible for managing the fund, making investment decisions and ensuring that the fund reaches its goals. Moreover, both a hedge fund manager and mutual fund manager are subject as investment advisers.

Both a hedge fund manager and mutual fund manager fall into the same definition of "investment adviser". However, considering their investment objective, investment risk, investment ability, type of investor, and the impact that each fund manager can pose to the financial market, the conclusion is that both have to be regulated differently. [43]

First, the main reason that makes hedge fund different from a mutual fund is the investment ability. The hedge fund has an ability to use leverage; it allows a hedge fund manager to multiply their capital which later will benefit to generate profit. Most hedge fund manager uses leverage as part of their trading strategy. A hedge fund manager can obtain leverage through a variety of means, which depends on the type of securities traded by the hedge fund, creditworthiness, or short-term funding including borrowing. Sometimes, the hedge fund can run positions up to 40 times of their capital.[44] Furthermore, most of the hedge fund trading activities involve speculation and risky transactions. On the other hand, a mutual fund manager is restricted to use leverage; they can use it only for the actual capital they have. They are also limited to invest in derivatives for a certain amount. When considering the impact that this fund can pose on the financial system, it seems that a hedge fund is more likely than a mutual fund

[42] Ibid.

[43] Lauren Treadwell, Demand Media, "The Responsibilities & Duties of an Investment Adviser" [online] available from: http://work.chron.com/responsibilities-duties-investment-adviser-16210.html

[44] Stuart A. McCrary, "How to create and manage A Hedge Fund" Page 115.

regarding transactions and highly speculative activities. Furthermore, many financial institutions are now interested in investing in hedge funds because they can generate more profit than other investment vehicles. Considering how a hedge fund is interconnected with other financial institutions and highly speculative activities, it may cause a domino effect to the whole financial system if the hedge fund collapses. [45]

A hedge fund manager has to comply with the regulations designed to monitor their activities according to the risk that they may pose to the financial system. On the other hand, a mutual fund manager has less potential to pose that kind of risk on the financial system, but there are investor protection concerns because a mutual fund publicly offers their interest to the public. If the information is inaccurate or fraudulent, the damage would be widespread and many investors would suffer from those losses. Hence, a mutual fund manager also has to be regulated, however, the main purpose of regulating a mutual fund manager is to protect investors, and ensure that each investor receives accurately and correct information and provide fund transparency which allows the authorities to examine any suspicious activities to protect investors. Nevertheless, a hedge fund manager is required to comply with this kind of regulation whether they are required to register or not.

The standard of investor' protection between a hedge fund and mutual fund is different due to the type of investor in each fund. When a mutual fund offers their fund or invites new investors, they do it publicly. Everyone can get the messages. Furthermore, there is no investor qualification for mutual fund investors, so a mutual fund investor can be anyone who is willing to invest in a mutual fund. By contrast, a hedge fund usually offers their interest through private placement, which means a hedge fund manager can offer their interest to prospective investors only a few investors per time. Moreover, there are investor qualifications for hedge fund investors, usually wealthy or sophisticated investors. The reasons that hedge fund investor qualifications require wealth and sophistication is because there are risks in hedge fund investment.

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[45] Felicia Dye, Demand Media, "The Duties & Functions of Fund Managers" [online] available from: http://work.chron.com/duties-functions-fund-managers-22246.html

Individual investors cannot hold this kind of risk, but the wealthy and sophisticated investors can.[46]

Nevertheless, hedge fund requires investment flexibility in every way possible. As such, there are some regulatory exemptions available. For instance, mutual fund managers are required to register their securities or interest issued by them before offering such securities to the public. By contrast, a hedge fund manager has an exemption that allows offering their interest via private placement. The reasons that a hedge fund manager has such an exemption is because there is no necessity to protect hedge fund investors. Every hedge fund investor is wealthy or sophisticated and can fend for themselves from financial loss. Second, considering the cost of protection and time consumption during the registration and filing process means such cost will raise the fund's operation cost, which is unnecessary. In other words, each hedge fund investor is wealthy and sophisticated; they can protect themselves by requesting any necessary information from the hedge fund manager to do the due diligence by themselves. Compared to a mutual fund investor, they are less sophisticated about understanding the balance sheet, financial statement, and other financial documents. Lastly, a hedge fund manager offers their interest via private placement, compared to a mutual fund manager, who offers their interest publicly. When considering the damage, a mutual fund can pose damage on a widespread scale because everyone can receive that information. This is compared to a hedge fund, where their interest is only offered on a slight scale. Nevertheless, the exemption is only available when a hedge fund manager meets the exemption qualifications.

In conclusion, there are slight differences in terms of regulation between a hedge fund manager and a mutual fund manager. In other words, both a hedge fund manager and mutual fund manager are subject to the Anti-fraud provision, which prohibits any investment adviser from committing fraud against investors. Nevertheless, a hedge fund manager may have some exemptions from the disclosure requirement due to cost, time-consumption, and type of investor. An exemption makes them different from a mutual

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[46] The U.S. Investment Advisers Act, Section 203(b)(3).

fund manager in terms of management flexibility. On the other hand, a hedge fund is restricted to making offers to a specific type of investor.

2.5.1.1 Registration requirement

The roles and duties of a hedge fund manager and mutual fund manager are similar to each other because each of them provides investment advice and makes the decisions for investors' money. According to the U.S. Investment Advisers Act, which classes both hedge fund managers and mutual fund managers as investment advisers, [47] they are required to register with the SEC.

Normally, investment advisers are required to register with the SEC; the registration will provide an information database for the authorities because, during the registration process, every investment adviser has to file material information requested by authorities. The authorities may use that information to examine any suspicious activities or analyze the information to forecast future financial market trends. The main reason that requires an investment adviser to register with the authorities is to protect investors. During the registration process, every investment adviser has to fill in the form called "ADV," [48] which provides a series of questions about the investment adviser. Each investment adviser has to declare to the authorities data such as fee schedule, conflict of interest, education and business background of management, as well as the type of advisory services offered. Furthermore, an investment adviser is required to deliver clients a summary of material changes annually to the form ADV or the brochure, which must be kept up to date.[49]

[47] The U.S. Investment Advisers Act, Section 202.

[48] Form ADV is the uniform used by investment advisers to register with both the Securities and Exchange Commission (SEC) and state securities authorities, which an investment adviser have to fill the form and send it to the SEC in order to register as an investment adviser. The SEC will reviews the information to process registrations and manage its regulatory and examination programs. In addition, the form ADV consist of two parts, part of this information are available to the public on the SEC's Investment Adviser Public Disclosure (IAPD) website. See. The U.S. Securities and Exchange Commission, "Form ADV" [online] available from: http://www.sec.gov/answers/formadv.htm

[49] Ibid.

The hedge fund markets have been formed and developed based on market supply and demand, which later successfully settled as an unregulated private market with the help of the safe harbor rules available for them. Nonetheless, the U.S. SEC raised some regulatory concerns in 2003 about the hedge fund industry. Among other things, the market had grown dramatically within a relatively short period, Further, this trend was anticipated to continue going forward. On the other hand, there was little information available about them. Also, many substantively unsophisticated investors were exposed to the market, both directly through the accredited investor or qualified purchaser threshold rules and indirectly through a fund of funds or pension funds. Law enforcement tools against their potential misconduct were only available on a limited basis. Based on these regulatory backgrounds, the U.S. SEC made an attempt to regulate hedge fund management directly by making the hedge fund advisers subject to the mandatory registration requirement.[50]

On the other hand, a hedge fund is an alternative investment vehicle which has more investment flexibility than a mutual fund. Hence, balance of regulatory oversight and exemption is needed. The regulators provide an exemption for a small hedge fund manager, which allows them to maintain unregulated status. Also, there have been no particular regulatory concerns raised against them because they are relatively small in size. As such, they used to have insignificant negative impacts on the market. As a result, many hedge fund managers tend to avoid the registration obligation by relying on the safe harbor rules of Section 203(b), which exempts any investment adviser that act solely as an investment adviser to one or more qualifying private funds, and manages private fund assets of less than $150 million.[51]

As demonstrated above, a hedge fund manager can rely on the private fund adviser exemption to maintain unregulated status. Also, relying on this exemption means a hedge fund manager is almost entirely free from the onerous compliance requirement, which allows them to manage the fund more flexibly and freely than a mutual fund

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[50] The U.S. Securities and Exchange Commission, “Registration Under the Advisers Act of Certain Hedge Fund Advisers” [online] available from: https://www.sec.gov/rules/final/ia-2333.htm

[51] 17 CFR 275.203(m)-1(a), “Private fund adviser exemption.”

manager. However, a hedge fund manager is still subject to the anti-fraud provision of the Investment Adviser Act, just like a mutual fund manager.

2.5.1.2 Disclosure framework

Both a hedge fund manager and mutual fund manager fall into the definition of investment adviser, but a hedge fund manager may not be subject to some of the same regulations designed to protect investors. A mutual fund manager is required to register with the SEC by using an ADV form, which means such information will available to the public.[52] Also, they have to register their interest or securities before public offering to investors. During the securities registration process, the authorities will examine all information regarding the securities and require the mutual fund manager to provide necessary information to the authorities to ensure that the securities issued by a mutual fund are accurate. Moreover, mutual fund managers are also required to deliver a prospectus, which must contain material information regarding the securities. According to the U.S. Securities Act Section 5, a mutual fund manager is required to register their securities with the SEC before making a public offering and delivering a prospectus containing specified categories of information about the issuer and securities.

Unlike mutual funds, hedge funds are not subject to some of the regulations designed to protect investors. Depending on some assets in the hedge funds managed by a manager, some hedge fund managers may not be required to register or file the public disclosure with the SEC. Hence, hedge funds are not obliged to provide the same level of disclosure as a mutual fund. [53]

As a result, there are several exemptions available for hedge fund managers to rely on, which allow the hedge fund manager to avoid those disclosure requirements if they meet the qualifications.

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[52] The Investment advisers Act, Section 210 (a).

[53] U.S. Securities and Exchange Commission, “Hedge Fund” [online] available from: http://www.sec.gov/answers/hedge.htm

First, a hedge fund manager may exempt from registration under the private fund exemption rule if they act solely as an investment adviser to one or more qualifying private funds and manage private fund assets of less than $150 million.[54] As a result, such hedge fund managers are free from registration and have no obligation to file an ADV form. In other words, a hedge fund manager is free from registration if it means such managers are not required to file an ADV form.[55] Once a hedge fund manager is free from registration, that manager is free from the public disclosure requirement.

Nonetheless, a hedge fund manager may require registering their securities before the offer to their investors if such an offer is considered a public offering. In such a case, the hedge fund manager has to get through the securities registration process the same as a mutual fund. However, there is an exemption available for a hedge fund manager if relying on the private offering exemption in the Securities Act Section 4(a)(2) and Rule 506 of Regulation D, under the exemption. Generally speaking, private placements are not subject to some of the laws and regulations designed to protect investors, such as the comprehensive disclosure requirements that apply to a registered offering.[56] There is no requirement to provide an offering document to prospective investors; most hedge fund managers provide written information to their investors in the form of a private offering memorandum (PPM). The PPM is a disclosure document that provides the terms and conditions of the hedge fund to the potential investors. This document is different from the prospectus that the mutual fund used because. First, this document is not verified by the authorities before delivering it to the potential investors. Compare this to a mutual fund manager, who has to provide the prospectus and have it verified by the authorities before delivery to investors. Second, a hedge fund manager can decide what information to deliver to investors as long as it does not go against the

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[54] 17 CFR 275.203(m)-1(a).

[55] Form ADV is the uniform form used by investment advisers to register with the Securities and Exchange Commission (SEC). The SEC reviews the information from the form to process registrations and manage its regulatory and examination programs. Moreover, part of the form will be available to the public.

[56] The U.S. Securities and Exchange Commission, “Investor Bulletin: Private Placements Under Regulation D” [online] available from: http://www.sec.gov/oiea/investor-alerts-bulletins/ib_privateplacements.html

anti-fraud provision. Compare this to a mutual fund manager, who has to complete the form provided by the authorities.

In conclusion, a mutual fund is a highly-regulated investment vehicle designed to be a safe investment vehicle for investors. Furthermore, most of the regulations that apply to the mutual fund are intended to protect investors. Thus, there is no any exemption for a mutual fund manager to avoid such disclosure requirements. On the other hand, a hedge fund manager may avoid disclosure requirements, which are the investment adviser disclosure requirements and registered securities disclosure if the hedge fund manager meets a certain exemption qualifications. Such an exemption may affect fund transparency and market stability because hedge fund managers provide information on their fund in a limited series of documents. Furthermore, a hedge fund manager can decide what information they want to disclose. As a result, there is little information available for investors, which might affect the investment decisions of each investor.

2.5.1.3 Recordkeeping and reporting requirement

The purpose of the recordkeeping requirement is to create a source of data for the authorities, which may be used to monitor financial activities. It is also used to supervise systemic risk related to hedge funds. There are differences in the type of information required by the authorities depending on the risk that each fund can pose and the size of the fund.

Normally, a mutual fund has less potential to pose a risk to the financial market compared to a hedge fund. However, a mutual fund investor mostly has less experience in the financial market. Thus, the purpose of such a record requirement is mainly for investor protection. Once the information is available publicly, everyone can have access and support the fund’s risk. Hence, there is no specific information and record required under this rule, but only general information regarding the fund. According to the Investment Adviser Act Section 204(a), which requires every investment adviser to make and keep for prescribed periods of record such as accounts, correspondence, memorandums, tapes, discs, papers, books, and other documents or transcribed

information of any type. Furthermore, an investment adviser has to make copies of those records and disseminate such reports appropriately in the public interest or for the protection of investors. Moreover, all records of such an investment adviser are subject at any time or from time to time, to such a reasonable period and examination by the authorities.[57] [58]

On the other hand, a hedge fund is a risky investment vehicle with the potential to pose significant financial damage to the financial system. Hence, the Dodd-Frank Wall Street Reform and Consumer Protection Act requires a hedge fund adviser to maintain certain records and file reports with the SEC for the purpose of providing the SEC and other authorities with an opportunity to identify potential systemic risk in the financial system and address those risks before they can occur. Most of the records requirement relates to the systemic risk concern, for which hedge fund managers must provide a particular type of record for the authorities and also make it available anytime when requested. Under Section 404 of the Dodd-Frank Act, it requires a hedge fund manager to maintain records such as the number of assets under management, use of leverage, counterparty credit risk exposure, trading and investment positions, valuation policies, type of assets held, side arrangement or side letter, and trading practice. A hedge fund manager has to maintain such records for a period, and shall make them available to the authorities at anytime.[59]

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[57] The Investment Advisers Act Section 204 (a) stated that " In General Every investment adviser who make use of the mails or any means or instrumentality of interstate commerce in connection with his or its business as an investment adviser, shall make and keep for prescribed period such record (as defined in Section3(a)(37) of the Securities Exchange Act of 1934), furnish such copies thereof, and make and disseminate such reports as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors. All records of such investment advisers are subject at any time, or from time to time, to such reasonable periodic, special, or other examinations be representatives of the Commission as the Commission deems necessary or appropriate in the public interest or for the protection of investors.

[58] The Securities Exchange Act of 1934 Section 3(a)(37) stated that" The term ''records'' means accounts, correspondence, memorandums, tapes, discs, papers, books, and other documents or transcribed information of any type, whether expressed in ordinary or machine language.

[59] The Dodd-Frank Act, Section 404 (b).

A hedge fund manager with assets under management of less than $150 million who acts solely as an adviser to private funds is exempt from registration as an investment adviser under the Dodd-Frank Act. Such hedge fund managers are not subject to the record keeping requirements mentioned above.

Moreover, most investment advisers are required to file a report form once a year or quarterly based on the type and size of the fund. Mutual fund managers are required to report general information about their fund's information annually via ADV form. Also, such reports must be delivered to their investors and made available to the public.

On the other hand, hedge fund tends to be regulated based on systemic risk concerns. Hedge fund managers are required to file more specific information about their fund activities such as fund performance, use of leverage, assets held, etc. Such a report would create a source of data for the authorities, which could be used to monitor systemic risk in the financial market. Moreover, the amount of information required to report and the frequency depends on the amount of the assets under management and the type of private fund managed.[60]

A hedge fund manager who has assets under management of at least $150 million is required to report periodically to the authorities; such a report only requires basic information regarding the hedge fund they manage. This annual reporting requirement includes general information such as the type of private funds (e.g., hedge fund or private equity) and information relating to the fund's size, leverage, types of investors, liquidity, and performance. However, a larger hedge fund is required to report more detailed information and more frequently. For instance, a hedge fund manager who manages at least $1.5 billion in hedge fund assets must report quarterly and provide aggregate information on their hedge fund's exposure, geographical concentration and turnover by asset class, as well as direct and indirect forms of leverage and liquidity.

[60] U.S. Securities and Exchange Commission, "Annual Staff Report Relating to the Use of Data Collected from Private Fund Systemic Risk Reports", [online] available from: https://www.sec.gov/reportspubs/special-studies/im-private-fund-annual-report-081514.pdf

Nevertheless, any hedge fund adviser who has less than $150 million in assets under management is exempt from those reporting requirements mentioned above.[61]

2.5.2 Marketing

In the U.S., there is a regulation used to regulate fund marketing and advertising as stated in Section 5 of the Securities Act; it prohibits offers of securities unless complying with strict disclose requirements imposed by Section 10 of the Securities Act. Nevertheless, the term "offer" is broadly defined under Securities Law to include any written communication designed to engender investor interest in security. It also includes any mass communication intent on offering securities to investors. Hence, anyone willing to publicly offer their securities must provide a prospectus and comply with the disclosure requirement.

The nature of mutual fund marketing usually engages mass communication and public offerings. Thus, it has to hold itself out and advertise, so it has to comply with the law by providing a registered prospectus before any offering to the public. Under the Securities Act Section 10, the mutual fund manager may satisfy their prospectus delivery requirements by providing an investor with a "summary prospectus." The prospectus must provide investors with a summary of key information about a fund presented in a standardized sequence, such as the fund's investment objective and goals, fees and expense, principal investment strategies, risks and performance, fund's investment adviser, brief tax information, the share purchase and sale process, including minimum initial investment requirements and procedures for redeeming shares. [62]

On the other hand, a hedge fund manager has choices in deciding whether to publicly or privately offer their securities. If they decide to offer their securities publicly, they have to comply with the Securities Act, which requires disclosing specific information through the prospectus, just like a mutual fund manager.

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[61] Ibid.
[62] K&L Gates, "Advertising the Mutual Fund" [online] available from:
http://www.klgates.com/files/Upload/DC_IM_05-Advertising.pdf

Nevertheless, there is an exemption for a hedge fund manager under Rule 506 of Regulation D and the Securities Act Section 4(a)(2), which provides "safe harbor" for a hedge fund to free it from the securities offering registration.[63][64] Also, general solicitation and general advertisement are not allowed when relying on this safe harbor rule. Normally, general solicitation and general advertisement are very broadly defined. It includes advertisement, article, notices or other communication published in a newspaper, magazine, or similar media, mass mailing, broadcasts on television or radio, materials contained on the website available to the public, or email messages sent to a large number of previously unknown persons. This no general solicitation or no general advertisement requirement may be avoided under the JOBS Act if the purchaser is limited to accredited investors and the issuer takes reasonable steps to confirm that the purchasers are accredited investors at the time of investment. It is another way to offer securities by using an exemption under Regulation D. However, existing safe harbors are also available. Thus, a hedge fund manager can choose one of these options at their discretion to offer the fund shares on a private placement basis.[65]

Hedge fund managers offer their securities through a "private offering." However, there are no specific disclosure requirements for offering documents. Most hedge fund managers provide written information to their investors in the form of a private offering memorandum. This document refers to both the prospectus and subscription agreement. The private placement memorandum (PPM) is a disclosure document that provides potential investors with the terms and conditions of a hedge fund. This document is similar to a business plan, except that this document focuses on the disclosure of facts rather than project results. The private placement memorandum includes a discussion of terms for the offering, the allocation of proceeds, and the risk factors inherent in the business and industry. Typically, the PPM contains all information about the fund, investment adviser, and the securities offered, as well as

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[63] The U.S. Securities and Exchange Commission, "Rule 506 of Regulation D" [online] available from : http://www.sec.gov/answers/rule506.htm

[64] 17 CFR 230.506

[65] Eun Jip Kim, "Rethinking Hedge Fund Regulation: Focusing on the U.S., the U.K., and Korea, Indiana University school of Law-Bloomington, Page 91

any other information considered to be material information by a potential investor. The PPM is accompanied by a subscription agreement and investor questionnaire. The subscription agreement is a contract to purchase a specified amount of securities at an agreed price and contains a statement that the investor has received and reviewed the PPM, is aware of the risk factors, and is a suitable investor. The investor questionnaire elicits information about the investor's background, employment, and investment or business experience. It is used, in part, to confirm the investor's accreditation and sophistication.[66]

2.5.3 Investor qualifications

A hedge fund and mutual fund are also different in terms of the type of investor. There is no investor qualification for investing in a mutual fund. Any individual investors can invest in a mutual fund. Investing in a mutual fund requires just a little money and the fee; an investor can make an investment with a small amount of money. A mutual fund was designed for individual investors because it provides significant protection standards, through which every investor can ensure that they are protected. Furthermore, mutual funds are restricted to investment in a certain amount and type of assets, which makes mutual fund investment safer than a hedge fund.

Nevertheless, there is a concern about who can invest in a hedge fund because hedge fund investors do not receive the same protection standard as mutual fund investors when regarding the risk and investment complexity in a hedge fund. Mutual fund investors receive protection since they receive an offer from the fund until the end of investment. In other words, the fund managers are required by law to provide and disclose all information accurately, which is verified by the authorities to their investors. By contrast, hedge fund managers are not obliged by law to provide those documents. Further, such documents are not verified by authorities before delivery to an investor. Moreover, a hedge fund manager can decide what information to give to

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[66] Management Services Group, “Hedge fund offering Documents” [online] available from: http://www.capitalmanagementservicesgroup.com/startahedgefund/offeringdocuments.html

investors as long as it does not violate the antifraud prohibitions.[67] The reason is that the relationship between hedge fund investors and the hedge fund is as shareholders or partnership. This type of engagement is not subject to the securities law.

Hedge fund investment requires high initial capital. The hedge fund investor also has to pay a high fee. As a result, the regulator has set a qualifications for an investor who can invest in a hedge fund called “accredited investor” or “sophisticated investor”.[68] As a result, hedge funds are only available for a particular type of investor. It also restricts other investors to protect them from financial loss in hedge fund investment. Each investor in a hedge fund must meet certain qualifications such as financial education, wealth, and entities.[69] For example, an individual must accomplish at least one of the following to qualify as an accredited investor: First, earn an individual income of more than $200,000 per year, or a joint income of $300,000, in each of the last two years and expect to reasonably maintain the same level of revenue. Second, have a net worth exceeding $1 million, either individually or jointly with his or her spouse. Alternatively, the investor should be deemed to have sufficient investing experience and knowledge to weigh the risks and merits of an investment opportunity. This kind of investor includes banks, insurance companies, pension funds, and investment companies. It is necessary to ensure that each hedge fund investor acknowledges that they invest in a risky investment vehicle. Also, each of them can

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[67] U.S. Securities and Exchange Commission, “Rule 506 of Regulation D” [online] available from: http://www.sec.gov/answers/rule506.htm

[68] An accredited or sophisticated investor is an investor with a special status under financial regulation laws. The definition of an accredited investor, and the consequences of being classified as such, vary between countries. Generally, accredited investors include high-net-worth individuals, banks, and other large corporations, who have access to complex and higher-risk investments such as venture capital, hedge funds and angel investments. Moreover, the purpose of the status designation is to protect potential investors from risk. The assumption underlying accreditation is that individuals or organizations who qualify will have sufficient financial sophistication to understand and take on the risks associated with certain investment offerings. Laws may require that some types of financial offerings may only be made to accredited investors. See. Lufrano Law, LLC, “The SEC’s Accredited-Investor Standard is Long Overdue for an Overhaul” [online] available from: http://www.lufranolaw.com/blog/-the-secs-accredited-investor-standard-is-long-overdue-for-an-overhaul

[69] 17 CFR 230.501

take a financial loss from hedge fund investment. More precisely, under Regulation D accredited investors are automatically deemed sophisticated regardless of whether they are sophisticated or not, so there is no need to protect them through mandated disclosure. It is a precondition for a hedge fund manager to comply with and satisfy the threshold conditions. That is the reason a hedge fund can be exempt from the registration requirement.

Also, mutual fund managers have no obligation to verify their investors once there is no investor qualification in a mutual fund. On the other hand, a hedge fund manager has to check their investors to ensure that each of them qualifies as accredited investors by reviewing their documentation, such as tax returns, bank and brokerage statements, and credit reports.[70] The accredited investor qualification allows a hedge fund manager to more easily market and solicit new investors with no regulatory requirement via private placement, as long as they can independently prove that the investors are accredited.[71]

2.5.4 Prohibited activities

Under the Investment Adviser Act Section 206, it is the general anti-fraud provision governing investment adviser, even such investment advisers that are exempt from registration are still subject to certain anti-fraud provisions. Hence, every investment adviser includes a mutual fund manager and hedge fund manager, whether such investment advisers are required to register with the authorities or not. Under the anti-fraud provision, both hedge fund managers and mutual fund managers are prohibited from engaging in fraudulent, deceptive or manipulative activities; investment advisers are also prohibited from engagement, whether for direct or indirect transactions, that act as fraud upon any client or prospective client. It also prohibits

[70] U.S. Securities and Exchange Commission, “Rule 506 of Regulation D” [online] available from: http://www.sec.gov/answers/rule506.htm

[71] Chris Kentouris, “New Criteria for US Accredited Investors: Looming Pain for Alt Funds?” [online] available from: http://finops.co/investors/new-criteria-for-us-accredited-investors-looming-pain-for-alt-funds/

misstatements, as well as omissions of material facts.[72] Section 206(1) and (2) of the Investment Advisers Act states that it is unlawful for an investment adviser to use a device, scheme or artifice to defraud a client or prospective client. The investment advisers must also refrain from engaging in any transaction, practice or course of business that operates as a fraud or deceit upon any client or prospective client. These section of the Investment Adviser Act are the foundation of the fiduciary duty owned by the investment adviser to their clients. For instance, it would be deceptive for an investment adviser to solicit any investors with promises of a guaranteed return on certain investments or make a false statement about the firm's track record. Also, it would be fraudulent or deceptive for investment advisers to assure prospective clients that investment is risk-free. [73] [74]

In conclusion, this rule applies to both registered and unregistered investment advisers, so even hedge fund managers that do not register have to comply with this rule. This rule prohibits false or misleading statements to both current and prospective investors. It also covers any actions taken to be an investment adviser on an investment pool managed by such an investment adviser, even if the fund is not currently offering, selling or redeeming securities.[75] Furthermore, this anti-fraud provision makes it illegal for any investment adviser to make a misstatement or omission of a material fact or conduct any activities which are considered fraudulent.

2.6 Regulatory concept for regulating hedge fund manager

In the past, the U.S. SEC lightly regulated and provided several exemptions for both hedge fund and hedge fund manager. However**,** the U.S. SEC started to have concerns about the rapid growth of the hedge fund industry, the stability of the financial market and investor protection as the SEC had no reliable data on the number of assets

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[72] A fact is deemed material if there is a substantial likelihood that a reasonable investor would consider it to be important. See. teadman v. SEC, 603 F. 2d 1126, 1134 (5th Cir. 1979), aff'd 450 U.S. 91 (1981)

[73] The U.S. Investment Adviser Act, Section 206.

[74] Les Abromovitz, "Anti-Fraud Provisions of the Investment Advisers Act" [online] available from: http://www.thinkadvisor.com/2012/01/01/anti-fraud-provisions-of-the-investment-advisers-a

[75] The U.S. Securities and Exchange Commission, "Prohibition of fraud by advisers to certain pooled investment vehicle" [Release No. IA-2628; File No. S7-25-06]

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under management and other information about each hedge fund manager. This lack of information compelled the SEC to take regulatory action focusing on hedge fund managers. The authorities wanted to understand and be able to respond to hedge fund fraud cases and address the problem precisely to adjust securities market regulatory direction. According to the concept of registration, the registration requirement objective is to collect a census of information about the industry, prevent hedge fund managers from committing fraud, and provide fund transparency. Achieving these goals benefits the securities market, law enforcement, policy makers, and investors.[76]

2.6.1 Reasons for regulating hedge fund manager

There are several reasons to regulate hedge fund managers. Mostly, the regulation intends to protect the investor, the public and the markets, as well as the companies invested in a hedge fund.

2.6.1.1 Investor protection

Generally in the US, UK, and South Korea, the investor who can invest in a hedge fund must be in some way “sophisticated”.[77] The rationale behind this is very straightforward; a sophisticated investor can “fend for himself”.[78] The sophisticated investor can afford high fees and has enough financial education to be able to understand the risks and complexity of investment. These kinds of investors do not need external regulation to protect them.

However, lack of disclosure leads to fraud and harmful information asymmetries. Generally, hedge fund managers keep their fund information secret, which means they do not disclose and have no duty to disclose such information regarding their holding assets. As such, hedge fund managers can diverge from stated investment strategies without investor knowledge, or simply engage in fraud. There are many examples of

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[76] Jonathan P. Straub, “Hedge Fund Registration: The shortcomings of the U.S. Securities and Exchange Commission’s “Private fund” Definition”.

[77] Rule 506 (b) of Regulation D.

[78] Troy A. Paredes, On the Decision to Regulate Hedge Funds: The SEC’s Regulatory Philosophy, Style, and Mission, 2006 U. ILL. L. REV. 975, at 991 n.62.

hedge fund managers falsifying their fund's performance figures to attract new investors while misappropriating funds. Furthermore, lack of disclosure may also lead an investor to not fully understand the complexity of investment, meaning they may not understand the risk of hedge fund investment.

It is acknowledged that hedge funds have provided many benefits to the market and investors, but the fund also has an adverse impact on the market and investors. In recent years, there has been fraud caused by hedge fund managers and other concerns such as fund transparency, misuse of leverage, conflicts of interest and false statements. It creates huge risk and losses to investors because the managers are the very persons that have unlimited discretion in investing and managing the funds' assets. As a hedge fund is a private investment vehicle, they can easily escape from oversight by the authorities. Sometimes, it might be too late for the authorities to realize that there are massive financial problems. As a result, it caught the intention of regulators to increase the registration standard and provide less exemption. By regulating hedge fund managers directly, the potentially negative impact that the funds may pose to the market and investors is minimized. As a result, the fund manager must comply with the Act by maintaining certain business records and delivering a disclosure statement to clients. The most important provision of this Act is the defrauding prohibition, which prohibits advisers from defrauding their clients.[79] Hedge fund manager registration will benefit not only hedge fund investors, but also other investors and the securities market because the SEC can extend its oversight, which eliminates opportunities for hedge fund managers to engage in unlawful activities. Moreover, it benefits the regulators and policy makers by providing better data from hedge fund managers.[80]

An unregulated hedge fund manager may cause a series of problems, as follows:

1) Fraud

A hedge fund manager is the person who takes control over all of the funds, so it is very easy for them to commit fraud. This information is based on the number of fraud

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[79] Securities and Exchange Commission "Registration under the Advisers Act of Certain Hedge Fund Advisers" 17 CFR Parts 275 and 279.

[80] Ibid.

cases committed by hedge fund managers. Hedge fund managers can commit fraud in many ways such as misrepresentation, false statements, and misleading statements. Normally, hedge fund managers make decisions about investment and selection of securities. However, sometimes they make a wrong decision and suffer a heavy loss. To hide massive losses from investors, hedge fund managers may send phony account statements that materially overstate the performance and value of the fund. The fund manager sends inaccurate statements to the fund's investors, after which such a manager attempts to cover up the losses in trading because they thought they could earn back the fund eventually. In the case of the Manhattan Investment Fund, it took more than three years for investors to realize the fraud.[81] [82]

Usually, fraud committed by hedge fund manager use the same method. The classic fraud begins with the hedge fund manager claiming to be a successful hedge fund manager with a large amount of capital. Subsequently, the manager starts to solicit investors with promises of consistently high returns when, in fact, the fund never made a real investment. However, the hedge fund manager withdraws and spends the money. Meanwhile, investors are requesting their returns. The manager refuses or delays the redemption requests. Finally, the manager creates a fictitious fund employee, who sends one investor an e-mail claiming that he had died, to get rid of the investor's request.[83]

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The problem of fraud committed by hedge fund managers is one of the top problems because of the lack of regulatory oversight. They send a balance statement directly to their investors with no approval of authorities compared to registered funds like a mutual fund or private fund, which has to get approval for each document before delivery to investors. For example, if the fund manager sends the portfolio statement directly to the investors, the investors in such a case never realize whether or not the fund bought stock or the balance sheet is an overstatement. The U.S. SEC believes that

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[81] Securities and Exchange Commission, "SEC Charges Hedge fund and its adviser with Fraud Emergency Relief Ordered", Litigation Release No.16412/ January 19, 2000.

[82] Colleen Debaise, "Berger is charged with Securities Fraud in Manhattan Investment Fund Case" The wall street journal. August 25, 2000.

[83] U.S. Securities and Exchange Commission, "SEC Announces Fraud Charges Against Purported Hedge Fund Manager" [online] available from: http://www.sec.gov/news/pressrelease/2015-34.html

hedge fund managers being registered will prevent further fraud committed by hedge fund managers because the managers would have an obligation to send their business transactions and disclose material information to the authorities. The authorities can examine the information and also ensure that the investors are protected.

a) Magnus Peterson and the Weavering Capital case

Magnus Peterson was the founder of the Weavering Capital and the former manager of the Cayman Islands-based Weavering Macro Fund. Peterson launched the fund in 2003 on the Irish Stock Exchange, and it collapsed in 2009. He marketed the fund as low risk, attracting more than £500million from major institution investors in the U.K., Ireland and the U.S., such as pension funds and charities. When the fund started to lose money from investment, he made secret transactions with another offshore company named Weavering Capital Fund, which was also controlled by Mr. Peterson. [84]He traded in complex financial instruments called "interest rate swaps", artificially inflating the value of the Macro fund and disguising the losses from investors. Meanwhile, he failed to inform his investors about the losses. In 2009, the fund collapsed because the clients started to demand their money back and the fund had no money to return because the fund's investments were worthless. [85] Mr. Peterson was accused by the High Court Judge of committing fraud, forgery, false accounting, fraudulent trading, self-belief, and a gambler's mentality. He was found guilty of covering up rising trading losses by weaving a web of deception. Furthermore, Mr. Peterson had rewarded himself handsomely from investors' and pocketed £5.8 million, while his investors lost £354 million in the scam.[86]

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[84] Kirstin Ridley, Nishant Kumar, "Boss of UK hedge fund Weavering convicted in fraud case" [online] available from: http://www.reuters.com/article/2015/01/20/hedgefunds-fraud-weavering-idUSKBN0KT0SY20150120

[85] Caroline Binham "Weavering hedge fund founder Magnus Peterson guilty of fraud" [online] available from: http://www.ft.com/cms/s/0/8705c75e-9ff4-11e4-aa89-00144feab7de.html#axzz3fBuCOLI6

[86] Jame Salmon "Former City hedge fund manager Magnus Peterson found guilty of fraud after conning investors out of more than £350million" [online] available from :

b) Bernard L. Madoff Investment Securities LLC's Case

The Bernard Madoff scheme is one of the longest and biggest Ponzi schemes ever in modern times in the most monitored economic system in the world; the United States of America. It was discovered in December 2008. The scheme operated undetected for about 15 years and caused $50 billion in losses to investors.[87]

Bernard Lawrence Madoff founded Bernard L. Madoff Investment Securities LLC in 1960. One of the divisions of the company was the "advisory and investment management division", where investors could invest their money in a hedge fund. The fund generated above 10 percent over the years, which is a very high return. Madoff used a series of techniques that made it hard to discover the scam. One of the technique was selling all the stocks and any others assets at the end of each month. This way the hedge fund only reported the amount of cash to the authorities. It was also very hard for the SEC to track down the performance of the fund. It performed well, as shown on the balance sheet. Furthermore, investors had no access to their investment such as investment status or securities that the fund holding. Instead, they received emails with their account information and balance statement each month. Until late 2008 when the financial crisis started, all investors were in a panic to redeem their investment from the fund. A day later, he confessed that the fund was operated as a Ponzi scheme. In June 2009, Madoff pled guilty to all charges, such as money laundering, mail fraud, and making false filings statements.

In conclusion, using an exemption from the U.S. regulation to avoid the registration process allowed him to operate business freely, without any authorities' oversight. As a result, he could deliver false trading reports to his investors. Further, it was hard for an individual investor to track down the trading performance of the fund because it was complicated and required advanced knowledge, so none of the investors realized it until it was exposed. Also, the regulations for investment advisers at that

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http://www.thisismoney.co.uk/money/markets/article-2917350/Former-City-hedge-fund-manager-Magnus-Peterson-guilty-fraud-conning-investors-350million.html

[87] Shahin Zarrabi, Lennart Lundberg "The Madoff Fraud" [online] available from: http://www.math.chalmers.se/~rootzen/finrisk/The%20Madoff%20Fraud.pdf

time were lightly regulated and did not require an investment adviser to submit any particular information about the fund they managed, such as assets under management, position holding, and trading reports. Doing so would have helped the authorities to track down the fund performance and see if the fund was performing as well as stated in the financial report.

2) Conflict of interest

Normally, hedge fund managers have to manage their funds in the best interest. However, the role of hedge fund managers in financial services industry means a hedge fund manager controls every aspect of their business. Thus, a hedge fund manager may have the opportunity and incentive to put his interest ahead of investors. As such, hedge fund managers may engage in a position of conflict of interest, which affect their performance and honesty. The U.S. SEC found a number of conflict of interest cases between hedge fund managers and their investors. There are many kinds of conflicts of interest, as follows:

First is the "non-disclosure of material facts". Sometimes, hedge fund managers might personally benefit from the relationship economically. They should disclose this information to their investors. They have to respond to investors' request for such information. For example, one of its three newly elected directors in Morgan Stanley had a family connection to a hedge fund that had been a client of a Morgan Stanly subsidiary; such a family connection may cause potential impairment of a director's ability to serve independently and honestly.[88]

Second is the "side by side management of client account". This usually happens when the manager manages two or more client accounts at the same time. It is caused by the difference in performance fee between two client accounts. Normally, a hedge fund manager would receive two types of fee, which includes a management fee of usually 1-2% of total assets and a performance fee, which depends on the agreement between client and manager. The managers may allocate the good securities to the

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[88] The New York Times ,"Morgan Director Has Ties to Hedge Fund", August 24, 2005 [online] available from:
http://www.nytimes.com/2005/08/24/business/24morgan.html?pagewanted=print&_r=0

client, who give them a higher performance fee.[89]Alternatively, the fund manager may provide one of the investors with certain information at times, make certain representations, or provide investment terms which are not available to other investors. In this situation, a hedge fund manager should make such disclosure enable other investors to assess the possibility of such side letters on their investment.

Third is the conflict of interest in the calculation of management and performance fees. The compensation for a hedge fund manager is typically based on the value of the underlying fund assets. Sometimes, hedge fund managers may fail to adhere to their stated valuation policies, in which hedge fund manager shift away from their benchmark to receive compensation.

Last is the conflict caused by an immediate family member or their staff. Usually, a hedge fund manager is the one who knows everything and also makes investment decisions. Thus, he might put his interest ahead of investors' interest by committing such activities as personal trading, insider trading, receiving gifts and entertainment, making political contributions and conducting outside business activities.[90]

Once a hedge fund manager has a fiduciary duty to clients, it is necessary to eliminate any conflict of interest between investors to gain reliability from the investors. However, limited information received from a hedge fund manager means it is difficult for both investor and authorities to detect a conflict of interest. Hence, a disclosure requirement would be an efficient method of detection.

As mentioned that conflict of interest is a big problem in hedge fund manager which can affect investor's reliability. Nevertheless, there is a hedge fund manager who get involved in this kind of situation. Mr. Feeley has a law degree and a graduate business degree. He started his own business called Feeley & Willcox, Inc. ("FWI"); it

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[89] M.L. Kornkasiwat Kasemsri, "The political Economy of Hedge fund and Globalization" Page 222.

[90] Michael Sakala, Daniel New " Managing conflicts of interest in the alternative investment industry' [online] available from: http://www.ey.com/Publication/vwLUAssets/EY_-_Conflicts_of_interest_in_alternative_investment/$FILE/EY-conflicts-of-interest.pdf

had two subsidiaries, FWS, a registered broker-dealer, and FWAM, a registered investment adviser. Almost all FWAM clients had accounts at FWS. Mr. Feeley held the following positions: he was president, director, treasurer, and a shareholder of FWI; he was president, secretary, and director of FWS; he was also the chairperson of the board, secretary, and compliance officer of FWAM. The FWI companies never realized their potential, however. In fact, FWI never earned a profit in any year. Mr. Feeley attempted to recapitalize FWI with an offering of stock accompanied by an effort to persuade securities holders to convert their debt securities into equity. However, the new capital from selling securities did not solve the financial problem. On April 1, 1995, Mr. Feeley transferred all of his licenses and customer accounts to Ernst and became an Ernst registered representative. However, Mr. Feeley did not disclose to his FWAM advisory clients that he would be receiving commissions from Ernst in connection with all trades he recommended and executed for FWAM advisory clients. He also did not disclose that he would use these commissions to repay the debt FWS owed Ernst, which Mr. Feeley had personally guaranteed.

In conclusion, Mr. Feeley was accused of violating the Investment Adviser Act in that he willfully aided, abetted and caused these violations by failing to disclose two conflicts of interest. First, they failed to disclose that FWAM and Feeley benefitted from the clients' purchase of the debentures and failed to disclose that Feeley would earn a commission from every trade he recommended if the clients transferred their accounts to Ernst.[91]

3) Fund transparency

Transparency of the fund is one of the most important things to consider before making an investment; it can give confidence to investors and provide a sound investment condition. However, a hedge fund does not provide enough transparency for investors. A lack of transparency is one of the largest complaints from hedge fund investors. This lack of transparency can expose investors to a rising level of risk without sufficient warning. For example, position transparency may help investors to monitor a

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[91] The Securities and Exchange Commission Washington, D.C. “Rel. No. 2143 / July 10, 2003” [online] available from : http://www.sec.gov/litigation/opinions/33-8249.htm

hedge fund manager about following the fund's stated strategies. Each investor who receives a month-end aggregated position report by industry can monitor whether the fund manager is drifting away from an earlier statement about the fund's industry concentrations.

Nevertheless, if hedge fund managers are free from registration, they have no regulatory obligation to disclose or file any information to their investors such as trading position, financial statement, and other material information. Furthermore, the information that they send to the investors may be unreliable because there is no authority to prove such information before it goes to the public. Also, a hedge fund manager will disclose information only to the point where they will gain benefit, which sometimes affects an investor's decision to make an investment. Moreover, such information is sent only to each investor of the fund in private. As a result, material information about whether the benefit is to the hedge fund manager or not must require disclosure and be proven by the authorities to create transparency. Furthermore, most of the information is relatively low quality as most of it simply passes on the information supplied by the fund managers, without any independent verification.

Hence, the basic regulatory requirement is to provide information to investors and public, which include information about the fund, hedge fund manager activities and transaction, and conflict of interest. Providing this information would help investors and authorities understand hedge fund manager activities and investment purposes. Both investors and authorities can use this information to identify risks.[92]

a) Diamondback Capital Management LLC and Level Global Investors LP

The SEC alleges that a hedge fund trader and seven fund managers and analysts were involved in a $78 million insider trading scheme based on nonpublic information about Dell's earnings and other inside information about Nvidia Corporation. The SEC alleges that a network of closely associated hedge fund traders at Stamford, Conn.-based Diamondback Capital Management LLC and Greenwich, Conn.-based Level

[92] Chair Mary Jo White, "Hedge Funds – A New Era of Transparency and Openness" [online] available from: http://www.sec.gov/News/Speech/Detail/Speech/1370539892574

Global Investors LP illegally obtained material nonpublic information about Dell and Nvidia. Investment analyst Sandeep “Sandy” Goyal of Princeton, N.J., obtained Dell quarterly earnings information and other performance data from an insider at Dell in advance of earnings announcements in 2008. Goyal tipped Diamondback analyst Jesse Tortora of Pembroke Pines, Fla., with the inside information, and Tortora in turn tipped several others, leading to insider trades on behalf of Diamondback and Level Global hedge funds.

The SEC also alleges that after obtaining the inside information from Goyal in advance of Dell’s first and second quarter earnings announcements in 2008, Tortora tipped his portfolio manager at Diamondback, Todd Newman of Needham, Mass. Newman traded on the information on behalf of the Diamondback hedge funds he controlled. Tortora also tipped Spyridon “Sam” Adondakis, an analyst at Level Global. Adondakis tipped his manager, Anthony Chiasson, who then traded on the inside information on behalf of Level Global hedge funds. During this period, both Adondakis and Chiasson lived in New York City.[93]

b) The Case of Stefan Chaligné

Stefan Chaligné is a hedge fund manager for the Cayman Islands-based "Iviron" who has been charged by the Financial Services Authority for manipulating the share prices of companies with the intention of boosting the value of his fund. He made significant purchases in eight securities on 31 December 2007, which in the case of two companies accounted for more than two-thirds of its average daily trading volume. He tried to increase the price of the shares listed on exchanges in Europe and Northern America to boost the value of his Cayman Islands fund called Iviron. The practice is known as "window dressing." The improper trades pushed the fund's value up by £2.7m, allowing Chaligné to increase the performance and management fees paid to him by the beneficiaries of the hedge fund. His scheme involved UK-based traders and impacted several markets across Europe and North America. The significant penalty

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[93] The Securities and Exchange Commission, “Hedge Fund Firms Diamondback Capital and Level Global Also Charged” [online] available from: http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171482492

and ban, along with the Tribunal's comments, underscore the seriousness of his misconduct.[94] [95]

2.6.1.2 Prevent systematic risk

Systemic risk is commonly used to describe the possibility of a series of correlated defaults among financial institution. Systemic risk is normally caused by a single major event that affects the whole financial system. [96] The failure of one hedge fund could cause a series of problems elsewhere in the financial markets.

Although a hedge fund does not play a significant role in the financial market, the hedge fund sector has grown and become more and more integrated with other financial institutions. As a result, their initial failure can cause financial problems. Once the failure has occurred, it is too late for regulators. Also, there are several reasons that a hedge fund can cause systemic risk. First is short selling, where there are concerns about opportunistic short selling. This can result in an unjustified fall in stock prices or a decline. Such a decline could be so rapid that the firm has little opportunity to dispel rumors about its financial health or provide additional capital before it collapses. Second, High leverage and poor liquidity, high leverage could cause the potential for a rapid drop in the liquidity of hedge fund investments, and it also causes systemic risk problems. Nevertheless, the regulators need much more information to assess the risk. However, the regulators only have partial information on hedge fund holding asset value, position, leverage, making the regulators unable to determine whether the systemic risk is accumulating. Even the prime brokers who do business with hedge

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[94] Jill Treanor, "Iviron hedge fund manager fined £900,000 for market abuse" [online] available from : http://www.theguardian.com/business/2012/sep/28/hedge-fund-manager-banned-market

[95] Kyle Caldwell, "FSA fines and bans French fund manager for market abuse" [online] available from : http://www.investmentweek.co.uk/investment-week/news/2213254/fsa-fines-and-bans-french-fund-manager-for-market-abuse

[96] Nicholas Chan, Mila Getmansky, Shane M. Haas, Andrew W. Lo, "Systemic Risk and Hedge Funds", The National Bureau of Economic Research, NBER working paper No.11200 Issued in March 2005.

funds are unable to see the hedge funds' booking record. Moreover, hedge fund portfolios always change, which leads to difficulty in assessing the risk.[97]

In history there are many hedge fund failure but not many of them cought public attention. The Long Term Capital Management fund is the most famous hedge fund collapse in history.

Long-Term Capital Management (LTCM) was a hedge fund founded in 1994. It started with $1 billion in initial capital. LTCM was strikingly successful from the start. It earned 28% in the first ten months and 43%, 41% in the following years.[98] The core strategy of LTCM can be described as "relative-value", or "convergence-arbitrage" trade. It tried to take advantage of small differences in pricing among closely related securities. The problem with such strategies is that they generate low profits. To generate more profit, the leverage has to be used to create attractive returns. The strategies worked excellently for LTCM. When it started, it generated returns of roughly above 40% per year. Unfortunately, high leverage also increased the risks. The balance sheet of LTCM was about $125 billion; it represents the total assets of the fund. Most of it was borrowed. Compare this to equity of about $5 billion; this represents an astonishing leverage ratio of 25 to 1.[99] Eventually, the troubles began in May and June of 1998. Due to its high leveraged nature and Russia's financial crisis, the fund suffered 16% losses in capital. Also, LTCM had to liquidate some positions at an extremely unfavorable moment and suffer further losses. In conclusion, the total losses were found

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[97] Lloyd Dixon, Noreen Clancy, Krishna B. Kumar, "Hedge fund and systemic risk" RAND Center for Corporate Ethics and Governance within RAND Justice, Infrastructure, and Environment.

[98] The Professional Risk Manager's International Association, [online] available from: http://www.prmia.org/sites/default/files/references/Long_Term_Capital_Management_Shory_version_April_2009.pdf

[99] Philippe Jorion, "Risk management Lessons from Long-Term Capital Management", European Financial Management. [online] available from: http://merage.uci.edu/~jorion/papers%5Cltcm.pdf

to be $4.6 billion, which lead to the Federal Reserve Bank of New York orchestrating an orderly rescue of LTCM.[100]

2.6.1.3 Marketing the Fund

A mutual fund can make a general solicitation or publicly introduce their fund. However, hedge funds are prohibited from making a general solicitation because the hedge fund is a risky investment vehicle that needs to restrict number and type of investors who can have access to a hedge fund. As a result, it is necessary to regulate a hedge fund manager to market only qualified investors.

A hedge fund' s advertisement is one of the top five problem areas identified by the SEC. Hedge fund managers try to expand their assets gathering. Their advertisements are becoming more prominent and essential to the success of investment firms. There are problems concerning the SEC, which include a deficiency in performance calculations such as overstating performance results, comparing the result to inappropriate benchmarks, failing to disclose material information regarding the calculation methods behind performance returns, and advertising returns in a misleading manner.[101]

Moreover, modern technology helps people easily search for information about hedge fund investment, which affects the growth of the hedge fund industry. However, the U.S. SEC have rules for advertisement of the fund, which means each fund has to comply by only advertising to the individual investors who qualified to invest in a hedge fund. Sometimes, a hedge fund manager may not directly advertise, but may show their fund performance indirectly through a journal, internet website, newspaper, or other

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[100] The Professional Risk Manager's International Association, [online] available from: http://www.prmia.org/sites/default/files/references/Long_Term_Capital_Management_Shory_version_April_2009.pdf

[101] Lori A. Richards, "Fiduciary Duty: Return the First Principle," Speech before the Eight Annual Investment Adviser Compliance Summit (27 February 2006).

methods that make it hard for regulators to a particular type of people and content that people would receive from their advertisement.[102]

Nevertheless there is a case that hedge fund manager breached the marketing rule. Mr. Malik was the founder and control person for American Bridge Investment Group, LLC (ABIG). He deceived investors when he sold them limited partnership interests in his hedge fund, variously know as Wall Street Creative Partner, Seven Sages Capital, LP, American Bridge Investment Group, LLC through various means of general solicitation such as website, email, phone calls, fact sheets. He assigned his employee to engage in cold-calling and then vetting potential investors to determine if they had money to invest. Once the potential investor had been identified, he took over exclusive communications with that person. Moreover, Mr. Malik employed a marketing strategy to cold-call potential investors by providing false information to reputable news media and information service providers. For example, based on information provided by Mr. Malik in March 2011, the Bloomberg report identified Malik as a rising fund manager. Bloomberg also reported that his fund had 92.73% return on investment for 2012 and showed that the fund had positive returns for every month in 2012. He also claimed to be operating a hedge fund open to high net worth, sophisticated investors that consistently yielded high positive rates of return. He described ABIG to investors and claimed that ABIG had approximately $100 million in assets under management. In fact, he conducted an egregious fraud. His fund never held more than $90,177 in assets. Furthermore, he used most of the investors' funds to simply support his lavish lifestyle.[103]

2.6.1.4 Investor qualifications

Over the years, there have been some concerns about the increasing number of individual investors interested in investing in a hedge fund, usually without their

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[102] See. "Implications of the Growth of Hedge Funds", Staff Report to the United States Securities and Exchange Commission. [online] available at: http://www.sec.gov/news/studies/hedgefunds0903.pdf

[103] Securities and Exchange Commission V. Moazzam "Mark" Malik and American Bridge Investment Group, LLC, available from : https://www.sec.gov/litigation/complaints/2015/comp23197.pdf

knowledge.[104] Furthermore, it has become much easier for individual investors to invest in a hedge fund.

The process of raising capital by hedge fund managers poses some legal and regulatory considerations. However, even before embarking on the actual capital raising process, there are categories of investors who can invest in a hedge fund. According to the fact that some certain types of investors may, by their legal status or others characteristics i.e. normally a wealthy individual, impose upon the hedge fund manager responsibilities or obligations that would not raise capital from an unqualified investor.[105]

A hedge fund raises capital from both individual investors and institutional investors. The institutional investors are usually professional investors who have much knowledge, experience, and money, compare to individual investors who have less knowledge and money than institutional investors. Thus, it is precarious for an individual investor to invest in a hedge fund.

Furthermore, a hedge fund manager is responsible for every fund operation and also responsible for verifying each investor's status by applying the suitability rule to non-professional investors who can filter an individual investor to access a hedge fund. Thus, even such investors are qualified but fail in the suitability check process. Such investors are disqualified from investment.

2.6.2 Reason for granting exemptions

The registration requirement might have an effect on a hedge fund business because registration would affect the operation cost and time-consumption. Most importantly, a hedge fund manager will take on an enormous obligation for the registration. Furthermore, an investor in a hedge fund has sufficient resources to be able to afford to lose all their investment. They also have sufficient knowledge to make a

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[104] FSA, Discussion paper 05/4, Hedge funds: A discussion of risk and regulatory engagement, [online] available from: www.fsa.gov.uk/pubs/discussion/dp05_04.pdf

[105] Scott J. Lederman "Hedge Fund Regulation" Page 7-2.

safe investment decision. Also, this group of investors can hire an expert on accounting, tax, law, or other specializations. It is unnecessary to provide high protection for these kinds of investors because they can protect themselves. As a result, registration might have an effect on the country because it is not attractive for a hedge fund to do business in a tightly-regulated country.[106] [107] [108]

Nevertheless, a minimum protection standard should be provided for an investor in order to safeguard an excellent condition for investment. Therefore, it is necessary to consider an appropriate regulatory standard for hedge fund managers to balance the cost and benefit from the regulation.

2.7 Regulatory measures for hedge fund managers

To identify fraud, false statement, and other problems, it is necessary to take a regulatory action on hedge fund managers to monitor their activities closely to provide investor protection and fund transparency.

2.7.1 Hedge fund manager registration

It is obvious that the problems caused by hedge fund managers are from the lack of regulatory oversight. The authorities have no information about hedge funds or hedge fund managers. As a consequence of no information, it is very hard to control them.

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Under the U.S. Investment Adviser Act, the registration of an investment adviser is required for every adviser, including hedge fund managers to file a registration form called the "Form ADV," which was developed jointly by the SEC and the North American Securities Administrators Association (NASSA). The ADV consists of two parts which the investment advisers must complete. This will serve as the basis of information for the SEC and their investors. Inside the ADV is a lot of information such as investment adviser background information, investment adviser

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[106] Ibid.

[107] Stuart A. McCrary, "Hedge fund Course" Page 128.

[108] Luther R. Ashworth II, "Is hedge fund adviser registration necessary to accomplish the goals of the Dodd-Frank Act's title IV?" Washington and Lee Law Review winter, 2013.

business, conflict of interest, securities in custody, related persons, and disciplinary history.[109]

The purpose of registration is to put hedge fund manager to the system and under regulatory oversight which is easier for the regulators to oversee their business closely and take control hedge fund industry. This registration information the authorities would prevent fraud and enable early detection. Furthermore, this information in the ADV form is made available to the public. Every investor can have access to this information and can make a decision before making an investment with a hedge fund manager.

2.7.2 Disclosure obligations

A hedge fund manager has duties to disclose every material information to investors with sufficient frequency and detail, including financial risk information and potential conflicts of interest so that the investors can consider all the information. Investors would be able to make an informed decision regarding investment in a hedge fund and appropriately monitor or manage their investment risk. There is much information that a hedge fund manager has to disclose to investors such as annual audited financial statements, performance information, the disclosure of potential conflicts of interest, and disclosure of counterparties agreement. Also, each report must disclose timely and accurately.

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Under the U.S. Code of Federal Regulations Rule 204-3 commonly referred to as the "brochure rule", every registered investment adviser is required to deliver each client or prospective client a ADV Part 2A form (brochure) and Part 2B (brochure supplement), which consists of the adviser's business practices, conflict of interest and background of the investment advisers and its personnel. Moreover, such an adviser has to deliver the brochure to clients before or at the time the adviser enters into an investment advisory contract with clients. Furthermore, this rule also requires an

[109] Clifford E. Kirsch "Investment Adviser Regulation a step-by step Guide to Compliance and the Law" Chapter 4

investment adviser to deliver any material change since they last sent off a brochure to each client, within 120 days after the end of the adviser's fiscal year.[110]

2.7.3 Report keeping requirements

The purpose of recordkeeping is to ensure the retention of accurate and complete records. It may also include appropriate maintenance of original copies.

Under the Investment Adviser Act Section, 204 and Rule 204-2, a registered hedge fund manager is required to maintain and preserve specified books and records and make them available to the Commission examiners for inspection.[111] Furthermore, this provision required hedge fund managers to maintain much information such as financial records, corporate records, trade data, accounting records, a document relating to valuation, order memoranda, written communications, copies of all advertisements and performance information, and client disclosure.[112] Also, this rule specifies the period that a hedge fund manager must retain such records, which is five years.

Hedge fund managers and their advisers may exercise investment discretion over the equity securities held by the fund. Thus, they are deemed to own beneficially any equity securities owned by the fund. Under the Securities Exchange Act Section 13(d) and 13(g), requires any person who, after acquiring beneficial ownership of any equity securities registered under Section 12 of the Securities Exchange Act, files a beneficial ownership statement.[113]

2.7.4 Hedge fund marketing

Marketing is one of the most important functions of a hedge fund manager. Effective marketing increases the size of the assets under management, which leads to

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[110] The U.S. Securities and Exchange Commission "General Information on the Regulation of Investment Advisers" [online] available from: http://www.sec.gov/divisions/investment/iaregulation/memoia.htm

[111] Ibid.

[112] See. 17 C.F.R. 275.204-2

[113] The Securities Exchange Act, Section 13(d),13(g).

a higher fee. Especially for a new fund, the world does not beat a path to the door of a new hedge fund, regardless of the freshness of the investment plan, For certain funds, past performance simplifies the marketing efforts, but a typical hedge fund needs the story about its performance, good and bad.

Normally, a hedge fund falls into the definition of an investment company under the U.S. Investment Company Act. The interests that are offered or sold to investors are also deemed as securities under the Securities Act, regardless of the legal entity of the fund.[114] As a result, any interests offered or sold to investors are subject to securities. A hedge fund is subject to registration requirements under the Securities Act when they offer or sell the fund interests to prospective investors, subject to certain limited private offering exemptions or the safe harbor rule available under the Securities Act Section4 (2).

Under the Securities Act Section 4(2), an exemption is provided for a hedge fund from the registration requirement when they offer or sell their interest, which are subject to security under the Securities Act. Thus, the hedge fund can offer and sell interests on a private placement basis.[115] The private offering exemption is based on the same premise as the private fund exemption in that a private fund needs to satisfy the private offering safe harbor conditions as a prerequisite to satisfying the threshold conditions for the private fund. The private offering is limited to accredited investors, who are deemed to have financial sophistication to protect themselves regarding wealth, knowledge, and experience. Moreover, all communication between a hedge fund manager and investors is protected by the law. In other words, all the information that a hedge fund manager delivers to investors must be correct, accurate, and not overstated or misleading.

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[114] The Investment Company Act, Section 3(A)(1)(a) defined an investment company as “any issuer which holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities.

[115] 15 U.S. Code § 77d (2), the Securities Act Section 4(a) (2).

2.7.5 Investor qualifications

Only qualified investors can invest in a hedge fund because of the investor protection. It is one of the measures restricting unqualified investors to be away from a hedge fund. Furthermore, a hedge fund manager has a duty to do due diligence to identify that each investor is qualified by law. Thus, a hedge fund manager must accept an investment from a new investor only if he can reasonable believe that the investor is qualified.

Furthermore, even some of the investors are qualified. However, they might be prohibited investors. A hedge fund manager should identify those investors deemed as prohibited and accept investment from them, whether directly or on behalf of another person. A prohibited investor is a terrorist, money laundering or any individual or entities whose name on any list of prohibited person and entities as may be mandated by law or regulation.

Tin order is used to confirm the identity of each investor during the identification process. Hedge fund managers have to take reasonable steps to ascertain investor information. Also, hedge fund managers can require more documents such as financial statements, bank accounts, taxpayer identification, and social security numbers, as well as any other document needed to ensure that such investors are qualified and not prohibited to make an investment in a hedge fund.

2.7.6 Prohibited activities

Under the Investment Adviser Act, Section 206 have listed prohibited transaction designed to prevent fraud which applies to advisers registered with the SEC, which consist of a misstatement or misleading omissions of material facts and other fraudulent acts and practices in connection with the conduct of an investment advisory business. As a fiduciary responsibility, an investment adviser owns its client's loyalty and may not engage in such activities that may conflict with client’s interest without the client’s consent. For example, the principle transactions, under Section 206 (3) of the Act prohibits an adviser, acting as principal for its account, from knowingly selling any securities to purchasing any securities from a client for its account.

Under the Anti-fraud provision that also covers the advertisement of a fund, any adviser registered with the SEC is prohibited from using any advertisement that contains any untrue statement of material fact or is otherwise misleading. For example, the performance advertising that advertisements contain information about the performance of client accounts must not be misleading. An adviser registered with the SEC must also maintain records substantiating any performance claimed in an advertisement.[116]

2.8 Problems with unregulated hedge fund managers in Thailand

Hedge fund management has been expanding rapidly in Asia, which grew by almost 30% in 2014 and caught the attention of investors to make investments in Asian hedge funds. It has generated a return of about 11% on an annual basis over the past three years.[117] This rapid growth is expected to continue for the next few years. Hence, many countries in Asia reformed their financial regulations to support and promote the hedge fund business. Thailand is one of the Asia countries that expect money to flow in from other countries. As a result, Thailand should be prepared in many ways with legal measures and other financial policies.

2.8.1 Hedge fund manager registration

In the present day, Thailand does not legally promote or support the hedge fund business. There are several things that need to be prepared for a hedge fund business to legally operate in Thailand. As mentioned earlier, however, a hedge fund is a flexible investment vehicle that can be established in various forms. In Thailand, there is no single regulation which prohibits a hedge fund from being established in the form of a limited company. Hence, a hedge fund can be established in limited company form.

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[116] Rule 204-2(a) (16). See In the Matter of Warwick Capital Management, Inc., Initial Decision Release
No. 327 (Feb. 15, 2007). ("Respondent blamed a series of dubious calamities for their inability to produce records that would support the inflated numbers and created after-the-fact documents concerning the inflated numbers.").

[117] Bloomberg Brief " Focus on Asia's Hedge Funds" [online] available from: http://www.bloombergbriefs.com/content/uploads/sites/2/2014/09/Focus-on-Asia-Hedge-Funds.pdf

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Nevertheless, a limited company is regulated by the Ministry of Commerce due to its entity. Thus, a hedge fund which forms as a limited company is not subject as a securities business and also not within the SEC's oversight. Nevertheless, there are several obstacles for operating a hedge fund in a limited company form in Thailand. First, the Securities and Exchange Act Section 34 and Civil and Commercial Code of Thailand Section 1102 prohibit a limited company from making public solicitations. Thus, a hedge fund cannot publicly offer the fund to the investor. Second, Section 1222 of the Civil and Commercial Code of Thailand requires all new shares to be offered to shareholders in proportion to the shares held by the fund. In other words, new shares cannot be offered to new investors directly. Thus, there might be an obstacle for a hedge fund manager to raise additional funds or get more investors.

Basically, a mutual fund manager is required to obtain a license before operating their business. The licensing process would help the authorities to oversee each fund manager who was registered. Once a mutual fund manager is registered with the authorities, such a mutual fund manager is required to comply with the securities regulation. On the other hand, Thailand still has no specific regulation which applies to a hedge fund business, as mentioned earlier. Furthermore, there is no prohibition for a hedge fund to be established in a limited company form. Therefore, a hedge fund that is established in a limited company form is not within the SEC's oversight. An unregistered hedge fund and hedge fund manager could create several risks to investors and the financial market because they are not regulated by the SEC. They could operate their business freely without oversight from the authorities. Second, an unregistered hedge fund manager is not required to comply with any regulation designed to protect the investor. As such, they are not required to provide or disclose any information to the investor. Furthermore, they are not required to report a fund's information to the authorities, so the authorities could not assess the risk caused by a hedge fund, which could affect the ability to prevent financial risk.

Nevertheless, the Thai SEC is currently in the process of hearing arguments to allow a hedge fund to be established in Thailand.[118] Under the new proposal, a hedge fund might be regulated similarly to a mutual fund. Hence, if some of the mutual fund's regulations were applied to a hedge fund, the hedge fund manager might be required to obtain a license or register like a mutual fund manager. Furthermore, requiring a hedge fund manager to register would inform the authorities of the size of assets under management by the hedge fund industry in Thailand. It is a necessary tool to assess systemic risk due to the increase in the size of the hedge fund market and its role in the financial market.

2.8.2 Lack of regulatory duties

Generally, a fund manager in many countries, whether a mutual fund manager or hedge fund manager, has the duty to disclose information to the authorities and investors. However, if a hedge fund establishes as a limited company, the hedge fund manager is not required to comply with the disclosure requirement as a reporting requirement. Also, it could create a series of problems. Basically, a hedge fund business has the potential to pose risk to both investors and the financial market. Meanwhile, the authorities have less information and have no authority to oversee its business. In addition, a hedge fund manager is not required to provide a prospectus or disclosure standard for their investors. As illustrated before, the hedge fund business is a risky venture and a hedge fund's investors should be informed about the risk of investment. Generally, many countries require a hedge fund manager to provide a prospectus for their investors. Such a prospectus is similar to a mutual fund's prospectus, except a hedge fund's prospectus is required to provide additional information regarding its investment risk. A hedge fund's investors should be warned with regard to hedge fund investment risk.

Moreover, necessary information should be reported to the authorities for inspection in order to assess and inspect the hedge fund business. Hedge funds always carry substantial risk and manage large assets, which can affect the financial market. In

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[118] The Publications of the Thai Securities and Exchange Commission, "The easing investment restrictions of the mutual fund that offered to non-retail investor" (อกน.19/2558)

order to closely monitor the hedge fund business, the authorities should require a hedge fund manager to frequently report specific information to the authorities. Such information might consist of information on assets under management, use of leverage, risk analysis, value at risk, back test result, stress test result, investment result, etc.

2.8.3 Marketing the Fund

As mentioned before that a hedge fund is a very risky investment vehicle and complicated to understand, it is necessary to limit the number and type of investors who could get involved in a fund. If there is no restriction on marketing or offering of the fund, the hedge fund manager may offer the fund to an unqualified investor who is not suitable to make such an investment in a hedge fund. Unfortunately, such an investor might lose their entire investment if it fails. Second, an investor might misunderstand about the risk of hedge fund investment if a hedge fund manager does not explain and inform the investor regarding its investment risk, meaning the investor loses his investment without any risk warning.

Moreover, there should be some regulatory obligation required by a fund manager or sales person before accepting any investor. First, there should be some qualifications for a hedge fund investor, which would be used to separate qualified and unqualified investors. Second, the fund manager should be required to take some additional steps such as know the client analysis, suitability test, financial objective, investment horizon, and risk tolerance level. The fund manager is required to use the results from these tests to assess their investor and whether or not the investor is suited for the fund. Third, fund managers should have a regulatory obligation which requires them to provide all material information regarding the fund investment. Such information should include maximum potential loss, worst case scenario analysis, and other risk factors which might affect the fund investment. Moreover, providing such information is not enough to warn a hedge fund investor about its risk. The fund manager should be required to explain in detail regarding the investment and risk. Lastly, there should be some independent party who reviews and assesses investor understanding. Under this method, it could be ensured that each hedge fund investor was informed regarding the risk of hedge fund investment.

2.8.4 Investor qualifications

The main purpose of the qualified investor concept is to identify persons willing and able to invest in a hedge fund to ensure that each of them can bear the economic risk of hedge fund investment. They can be assessed by their wealth or financial experience. Also, a hedge fund manager has a duty to screen each investor before accepting any investment capital.

Generally, a hedge fund is only available for a specific type of investor; not everyone can invest in a hedge fund. An individual investor who is willing to invest in a hedge fund should have enough wealth to qualify as a high net worth investor. Under the Thai regime, there are some investor qualifications which are used to categorize an individual investor from a qualified investor, also called a “high net worth investor”. Comparatively, the high net worth investor qualifications between Thailand and foreign countries shows that Thailand appears to require an investor’s wealth to be slightly less than in other countries. Also, it seems such a qualifications is not high enough, which might lead to the inefficiency of qualification. Nevertheless, the Thai SEC is still hearing arguments on a new hedge fund qualifications proposal, also called an “ultra-high net worth investor”. This new qualifications would require more wealth from an individual investor. Under this new qualifications, a higher standard for a hedge fund investor qualifications would be set.

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Chapter 3

Hedge Fund Manager Regulations in the U.S., U.K. and South Korea

3.1 Background

The regulatory situation in the hedge fund industry, compared to financial intermediaries such as banks, mutual funds, and brokerage or insurance companies, has always been equivocal. On one hand, hedge funds operate in regulated markets, utilize the infrastructure of regulated financial centers and deal with regulated financial institutions to implement their strategies. They are, in a sense, indirectly regulated. On the other hand, hedge funds tend to structure themselves in such a way as to avoid direct regulatory oversight and escape the registration or licensing requirements applicable to investment companies. They want to operate with maximum flexibility, which is precisely what regulators do not want them to do.

In the past, dealing with the financial market was rarely challenging for the regulator because the financial market was not as complicated as today. For instance, there is no exemption available for the mutual fund industry, so every mutual fund and mutual fund manager has to comply strictly with the regulations. By contrast, a hedge fund and hedge fund manager relies on several exemptions available to avoid regulatory oversight and provide flexibility. When the financial market developed, the regulations used to oversee the financial market and hedge fund managers also needed to develop. There are cases caused by hedge fund managers. Usually, the cases relate to misrepresentation, undisclosed material information, fraud and also systemic risk. Thus, it would be better if hedge fund managers were regulated and overseen by the authorities to prevent them from committing prohibited transactions. It would also create fund transparency and reduce systemic risk.

The purpose of regulating a hedge fund and hedge fund manager focuses on financial market stability rather than investor protection. The hedge fund industry has a relationship with the banking sector and some other financial institutions. As a result, the risk exposure of to hedge fund industry may have a material impact on other

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financial sectors. If a hedge fund has fallen, it will affect others in a domino effect. Nevertheless, regulators do not totally ignore investor protection; they do provide necessary protection for investors to ensure that there are no unlawful activities committed by hedge fund managers. Most of the hedge fund regulations are similar to a mutual fund in terms of investor protection; each fund manager has to comply with the disclosure qualifications and registration process, except that a hedge fund manager may have some exemptions.

Regulatory environments and industry solutions are interdependent, so it is necessary to analyze both to understand the business landscape. This chapter will provide a snapshot of some of the major regulatory environments from hedge funds and mutual funds, as well as a comparison of both within and outside the U.S.

3.2 Hedge fund managers under U.S. regulations

3.2.1 Background

In the U.S., there are presently three sets of federal regulators that oversee financial institutions dealing with the public. First, the Securities and Exchange Commission (SEC) is concerned with public issues or trades of securities. Second, the Commodity Future Trading Commission (CFTC) monitors futures and commodities. Last, the Federal Reserve, the Office of the Comptroller of the Currency and the Office of Thrift Supervision are in charge of banks.

The U.S. SEC is a government agency whose objective is to protect investors, maintain the integrity of the securities markets, and ensure that all investors have equal access to certain basic facts about investments. The SEC derives its regulatory powers from a series of Acts, among which are:

- The Securities Act (1933), which regulates the issue of securities to the public, and the necessary information disclosure. Furthermore, Section 4(2),5 provides an exception for non-public offering for any investment fund including a hedge fund.

- The Securities Exchange Act (1934), which regulates brokerage firms, transfer agents, and clearing agencies as well as the nation's securities self-regulatory

organizations, including the stock exchange. The purpose of this Act is to regulate securities transactions by requiring every security that is going to trade on the market to register with the SEC. Specifically, Section 12(g) requires issuers including fund units to register and disclose information as well as make an annual report to the SEC. However, a hedge fund may avoid this requirement by relying on some exemptions available.

- The Investment Company Act (1940), which regulates the organization of companies that engage primarily in investing, reinvesting or trading in "securities", and whose own securities are offered to the investing public.

- The Investment Advisers Act (1940), which regulates firms or individual practitioners remunerated for advising others about securities investments. Every investment adviser is required to register as an investment adviser. However, a hedge fund manager may avoid this requirement by relying on an exemption.

In the past, hedge funds and hedge fund managers used to operate their business outside the scope of the authorities. However, regulators tried to oversee hedge funds and hedge fund managers after the financial crisis of 2008. As a result, they required both hedge funds and hedge fund managers to have regulatory oversight.

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Normally, security activities are regulated by the acts mentioned above. Also, the fund manager is subject under the Investment Adviser Act. Thus, every fund manager, whether hedge fund manager, mutual fund manager or private fund manager, is subject to this act. Once they are under the Investment Advisers Act, all of them have to comply with the same regulatory requirements and rules. However, a hedge fund is a unique investment vehicle that needs more flexibility than other investment vehicles. As such, the regulators provide an exemption for both hedge funds and hedge fund managers to support flexibility. As a result, every hedge fund manager generally has to comply with the laws. On the other hand, a hedge fund manager who met an exemption requirement would not be required to comply with the laws such as registration, disclosure requirement, and reporting requirement.

3.2.2 Hedge fund manager and mutual fund manager registration

In the U.S., there is an Act called "The Investment Adviser Act of 1940", which is used to regulate every investment adviser and the actions of an investment adviser. Under this law, firms and anyone compensated for advising others about securities investment is defined.[119] Once such person falls within the definition of investment advisers, they are required to register with the SEC and conform to several regulations designed to protect investors.

Both hedge fund managers and mutual fund managers fall into the definition of investment advisers. Hence, both hedge fund managers and mutual fund managers are required to register with the SEC and go through exactly the same registration procedure as a private fund manager.

Nevertheless, hedge funds are an alternative investment vehicle which needs more flexibility than others investment vehicle; it can be structured in various forms, such as a limited company or limited partnership, to avoid cost and time consumption in the registration process. Also, each hedge fund investor is deemed a sophisticated investor who can defend himself from financial loss. Thus, there is no need to provide them with more protection. By contrast, the mutual fund has to be structured in the form of a securities company only, and their investors are deemed unsophisticated investors who need high protection. As a result, the U.S. SEC grants an exemption for hedge fund managers if they satisfy certain limited exemptions available under the Adviser Act.

3.2.2.1 Exemption from registration

There are few hedge fund advisers who were registered as investment advisers with the SEC because they took advantage from Section 203(b) (3) of the Investment Advisers Act, also called a "private adviser exemption." As a result of this article, it

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[119] The U.S. Investment Advisers Act, Section 202(a) (11), defined an investment adviser as "any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities."

allows hedge fund managers to avoid registration with the SEC if they have fewer than 15 clients during the preceding 12 months and did not hold itself out to the general public as an investment adviser. Lastly, the manager was not an adviser to any SEC registered investment company.

- Fewer than fifteen clients

Typically, a hedge fund manager manages their client capital through a comingled investment vehicle such as a partnership, limited liability company, or corporation. Each is counted as a single client. As a result, a hedge fund manager may technically manage more than fifteen clients' capital.

Nevertheless, after the SEC amended Rule 203(b)(3)-1[120] to preclude treating a hedge fund manager as a single client, it fell within the definition of a "private fund". Thus, the hedge fund managers are required to "look through" the fund and count each beneficial owner as a client for the purposes of determining if it has fewer than fifteen clients as required under the exemption. As a result, many hedge fund managers may be subject to registration with the SEC.[121]

In conclusion, hedge fund managers must have less than fifteen clients and count each of them as a single client to satisfy this exemption.

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- Holding out

The concept of "holding out" is essentially a concept of voluntary action (i.e. a person voluntarily presents himself to the public as providing advisory services). A brief definition of holding out is that an individual who has done public advertising seeks clients. Examples include advertising in the yellow pages, professional listings, newspapers, designating himself as an investment adviser on business stationery or a

[120]§ 17 C.F.R. 275.203(b) (3)-1 Definition of "client" of an investment adviser.

[121] Scott J. Lenderman, "Hedge fund Regulation", Page.6-6

business card or encouraging word-of-mouth referrals from existing clients, or any mass communication.[122]

In conclusion, hedge fund managers remained unregulated or lightly regulated by relying on the safe harbor rules. The exemption allows hedge fund managers to offer or sell fund interests to accredited investors or sophisticated investors. The purpose of "private offering exemption" for hedge fund managers is that it provides management flexibility. Also, these private offering exemptions were justified based on the presumption that the sophisticated investors could protect themselves without any governmental protection.[123] Once hedge fund managers are free from registration, they are also free from regulatory requirement, while a mutual fund manager has no such exemption. Thus, they are fully subject to registration and other compliance requirements.

3.2.2.2 Registration procedure

Some hedge fund managers may avoid registration by using an exemption available in the Investment Adviser Act. However, those who have to register with the SEC have to comply with the exact same registration process as a mutual fund manager and private fund manager. Furthermore, investment advisers who are subject to registration are required to comply with several requirements and rules. One of the requirements is that an investment adviser must file a Form ADV or Form PF, depending on the size of the fund, which mainly contains two parts as follows:

Part one contains information regarding the fund, the fund's business practices, the persons who own and control it, and the person who provides investment advice on

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[122] Clifford E. Kirsch, "Investment Adviser Regulation a step-by-step guide to compliance and the law" Page. 2-6.

[123] Nevertheless, it is still debatable whether accredited investors, who are deemed financially sophisticated, are really financially sophisticated enough to protect themselves without paternalistic intervention by the government. See. "SEC Hedge Fund Report" available from: http://hb.betterregulation.com/exterjal/IOSCO%20PD142.pdf

the firm's behalf, as well as the minimum investment commitment, the current value of an asset and other information.

Part two must be provided to all clients and updated as often as necessary. It contains information about the advisory services offered by the firm, the fees being charged, the way securities are analyzed, and the discretion the adviser has over clients' investment, as well as general background information about the adviser and a description of any potential conflicts of interest.

After an investment adviser has registered with the SEC by filing Form ADV, they must comply with all the requirements of the Investment Advisers Act, which consist of the following:

- Registered investment advisers must have a written compliance manual in place and implement all its investors. The manual of conformity should be reviewed annually and include at least the policies for portfolio management processes (including trade allocation among clients and consistency of portfolios with clients' investment objectives, disclosures by the adviser and applicable regulatory restriction), proxy voting policies and procedures, trading practice, record keeping, marketing activities, disaster recovery and valuation.

- Registered investment advisers must designate a competent and knowledge Chief Compliance Officer (CCO) to oversee their compliance program and keep abreast of new developments in hedge fund regulation.

- Registered investment advisers must adopt a Code of Ethics to address issues such as conflicts of interest, personal securities reporting, pre-approval of certain transactions and reporting of violations of the code of ethic.

- Registered investment advisers must maintain books and records for almost everything they did regarding the management of clients' money for five years; this includes accounting records, advisory records, personal trading records, other records and e-mails sent and received.

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According to Section 204 of the Investment Advisers Act, registered investment advisers should have sufficient documentation to allow a complete recalculation of performance, e.g. the original records showing what was purchased and what was sold.

3.2.3 Disclosure Requirements

Every fund manager has an obligation to disclose material information to both investors and regulators, unless they meet the exemption qualifications. Nevertheless, both hedge fund managers and mutual fund managers fall into the definition of investment adviser, and are required to disclose material information. However, there are differences in disclosure requirements between them.

3.2.3.1 Mutual fund manager disclosure requirements

Under the Investment Advisers Act Section 203 (a), (c) every investment adviser including mutual fund manager is required to register with the SEC. Such a registration process requires each mutual fund manager to file a form and documents with the authorities. It is a mandatory disclosure rule for a mutual fund manager to disclose all material information to the public. The purpose of such disclosure is to protect the public interest by allowing investors to understand and assess the risk of investment. Hence, every mutual fund manager is required to file a form called "Form ADV", which is a form used during the registration process for investment advisers.[124] The ADV form consists of a series of questions and disclosure items that must be answered. Furthermore, according to the Investment Advisers Act Section 207, it is unlawful for any person to willfully make any "untrue statement of a material fact in any registration application or report" [125] filed with the SEC or "willfully omit or state in any such application or report any material fact that is required to be stated therein."[126]

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[124] U.S. Securities and Exchange Commission, "Form ADV" [online] available from : http://www.sec.gov/answers/formadv.htm

[125] See. The Investment Advisers Act, Section 207.

[126] Ibid.

The disclosure and reporting in Form ADV consists of information as follows:

1. Adviser background information, which is basic information to identify the entity including legal name, SEC file number, principal office and place of business, as well as primary contract person.
2. The adviser's business includes the number and type of advisory clients, compensation arrangements, asset under management, type of advisory service provided, and other business activities which an adviser may engage.
3. Conflict of interest means the adviser must identify any potential conflicts of interest between the adviser and their investors. It also included the adviser's financial industry affiliations and activities. Especially, the adviser has to disclose any information about the financial service activity of their "related person."
4. Custody, the adviser, have to disclose any their related person have any clients funds or securities in detention or not.
5. Additional compensation means any compensation that an adviser receives from or pays to third parties in connection with its advisory business. Such an adviser has to disclose any arrangement under which it receives economic benefit.
6. Disclosure of balance sheet means any advisers whose clients prepaid more than $500 in advisory fees at least six months in advance provide a balance sheet for their most recent fiscal year. The balance sheet must be prepared and audited by an independent public accountant. The adviser has to include the balance sheet in the disclosure statement and deliver it to each client, who must prepay more than $500 in fees.[127]

Once the adviser has registered, the adviser also has another obligation to update Form ADV to assure that such information is updated and accurate. An adviser is required to update the filing at least annually within ninety days of the end of the fiscal

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[127] See. Form ADV Part II.

year.[128]The annual filing must reaffirm the eligibility information contained and update the response to any other information that is no longer accurate.[129]

Also, such information is available to the public on the SEC's Investment Adviser Public Disclosure (IAPD) website,[130] to which investors can have access and will be favorable to investors' investment. Furthermore, such information is approved by the authorities, so the information receiver can rely on it.

Under Advisers Act Rule 204-3(a), a mutual fund manager that is registered or required to be registered under the Investment Advisers Act Section 203 generally must furnish each investor and prospective investor with a written disclosure statement. This disclosure statement (from now on referred to as a "brochure") may be either a copy of Part II of Form ADV or a written document containing, at least, the information required by Part II of Form ADV. Furthermore, the mutual fund manager must keep a copy of each brochure and any amendment or revision given or offered to be paid to investors or a prospective investor, who subsequently become a client as part of the records required to be kept under the Investment Advisers Act Rule 204-2(a)(14). A brochure contains information the same as in Form ADV or, at least, the information required by Form ADV. Such information includes information about an adviser's background and business practices, the type of business services it provides, the fee it charges, how it analyzes securities, any conflict of interest affecting it, and its role in the client's securities transactions. Importantly, an adviser must disclose any other information about its clients or prospective investors, even if not specifically required by the brochure rule. If disclosure is required by any other provision of the Investment Advisers Act, this would certainly include disclosure of certain material financial and disciplinary information as mandated by the Investment Adviser Act Rule 206(4)-4.

[128] The Investment Advisers Act, Section 204-1(a)(1).

[129] Form ADV: General instruction 4. Item 4 also provides that in addition to the annual updating amendment, the adviser have to amend its Form ADV by filing addition amendment (other than annual amendments promptly if information provide in response become inaccurate in any way or materially inaccurate.

[130] The SEC's Investment Adviser Public Disclosure (IAPD) website, www.adviserinfo.sec.gov.

3.2.3.2 Hedge fund manager disclosure requirements

Hedge fund managers fall under the definition of investment adviser, which requires complying with the disclosure requirement. However, under the private fund exemption rule, hedge fund managers may be exempt from registration if acting solely as a private fund adviser to one or more qualifying private funds and managing private fund assets of less than $150 million.[131] As a result, hedge fund managers are free from registration and also have no obligation to file an ADV. In other words, hedge fund managers are not subject to the mandatory disclosure requirement under the private exemption rule.

Nevertheless, there is a confidentiality concern on hedge fund disclosure. A hedge fund manager typically provides information about their fund in a limited series of documents. Rather than being widely distributed, these documents are restricted to serious prospective investors.

There is no regulatory disclosure requirement for a hedge fund manager to disclose their information to investors. As a matter of practice, the private offering memorandum or private placement memorandum (PPM) is one of the principal vehicles by which a hedge fund manager introduces it to potential investors. It is an overview document designed to provide a summary of the key elements needed to make an investment decision. The information disclosed in a PPM varies from one adviser to another, but it is general in scope and includes a considerable amount of surplus verbiage. [132]

Normally, the PPM contains information including the cover page, which usually contains the name of the issuer, a summary description of the securities to be sold, a date and a handwritten number inscribed to help record the destination of each PPM. Also, there is no disclosure standard in PPM, but the main section of a PPM typically includes an executive summary. There is also the firm and fund investment philosophy and objective, the biographies of investment advisers, a summary of the

[131] 17 CFR 275.203(m)-1(a).
[132] Francois-Serge Lhabitant, "Handbook of Hedge Funds" Page 118.

terms and conditions including the fees and expenses, the investment track record and prior fund performance, legal and tax matters, inherent investment risk and potential conflict of interest to investors.[133]

3.2.4 Recordkeeping and reporting requirements

Every investment adviser is required to maintain a certain record for a period. These records create the source of data for the authorities, which may be used to monitor financial activities and also supervise systemic risk related to every investment vehicle. However, there are difference in the type of information required to be maintained depending on the kind of investment vehicle and the risk that can be posed to the financial system.

3.2.4.1 Mutual fund manager recordkeeping

Mostly, the records required from mutual fund managers are used for the protection of investors and the public interest. There is no specific information and record required under this rule, but only general information regarding the fund. Under the Investment Advisers Act Section 204(a), which requires every investment adviser including a mutual fund adviser to make and keep for prescribed periods of record such as accounts, correspondence, memorandums, tapes, discs, papers, books, and other documents or transcribed information of any type. Moreover, such an investment adviser has to make copies of those records and disseminate such reports appropriately in the public interest or for the protection of investors. Also, all records must be available for inspection by the authorities at anytime.[134]

3.2.4.2 Hedge fund manager recordkeeping

A hedge fund is subject as a private fund, which requires a different type of information compared to the mutual fund. Also, a hedge fund tends to be regulated based on the systemic risk concerns as because hedge fund has the potential to pose significant financial damage to the financial system. As a result, the Dodd-Frank Wall

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[133] Ibid.

[134] The Investment Advisers Act, Section 204(a), and The Securities Exchange Act, Section 404(b).

Street Reform and Consumer Protection Act requires a hedge fund manager to maintain a certain record and file a report with the SEC. Providing the SEC and other authorities a source of data would create an opportunity to identify the potential systemic risk in the financial system and also to address those risks before they occur. According to the Dodd-Frank Act, most of the records requirements are typically related to systemic risk concerns. Under the rule, hedge fund managers are required to provide a particular type of record for the authorities and also require making it available for inspection at anytime requested. Under the rule, there is some specific information and records which need to be maintained, such as the number of assets under management, use of leverage, counterparty credit risk exposure, trading and investment positions, valuation policies, type of assets held, side arrangement or side letter, and trading practice. Also, hedge fund managers have to maintain those records for a period and shall make them available to the authorities of such records anytime.[135]

Nonetheless, any hedge fund manager with assets under management of less than $150 million that solely acts as an adviser to private funds who are exempt from registration as investment advisers under the Dodd-Frank Act. Such a hedge fund manager is not subject to the record-keeping requirement mentioned above.[136] However, the authorities may require that hedge fund manager to be exempted by this reason to maintain such records and report annually to the authorities if necessary or appropriate in the public interest or for the protection of an investor.[137]

3.2.4.3 Hedge fund and mutual fund manager reporting requirements

Normally, hedge fund managers fall under the definition of private fund adviser, which have an obligation the same as other fund managers like mutual fund managers to report any material information to the regulator. Hence, some hedge fund managers may be subject to the reporting requirement depending on their fund's size. However, that information is different from mutual fund reporting. Typically, mutual fund

[135] The Dodd-Frank Act, Section 404.

[136] The Dodd-Frank Act, Section 204(b) (1) and Section 408 (1).

[137] The Dodd-Frank Act, Section 408 (2).

manager reporting focuses on the fund manager and person related information and basic fund's information, while a hedge fund manager is required to provide specific information about a fund's performance, fund's transaction, position holding, and use of leverage. The reason that the regulators require different information is because of the different concerns for each fund. General speaking, the regulators on the mutual fund side try to provide a protection standard for each investor by providing material information for investors to assess the risk. On the other hand, there is a systemic risk concern for a hedge fund regarding the relationship between a hedge fund and other financial institution as well as the historical risk posed by a hedge fund.

Every investment adviser, especially mutual fund managers, is required to file a report via Form ADV annually. Mostly, the information that needs to be reported is the same as the one that was filed before, but mutual fund managers have an obligation to keep that information up to date and allow the authorities to oversee their fund's activities. Furthermore, mutual fund managers also have a duty to deliver those updated report to each investor.[138]

On the other hand, hedge fund managers are required to report information regarding financial market stability concerns by filing a form called "Form PF."[139] The purpose of Form PF is to provide the Financial Stability Oversight Council (FSOC), created by the Dodd-Frank financial reform legislation, with information to identify

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[138] The Investment Advisers Act, Section 204(a), and The Securities Exchange Act, Section 404(b).

[139] Form PF defines a "hedge fund" generally as any private fund (other than a securitized asset fund) that (a) pays a performance fee or allocation calculated by taking into account unrealized gains (other than a fee or allocation the calculation of which may take into account unrealized gains solely for the purpose of reducing such fee or allocation to reflect net unrealized losses); (b) may borrow an amount in excess of one-half of its net asset value (including any committed capital) or may have gross notional exposure in excess of twice its net assets value (including any committed capital); or (c) may sell securities or other assets short or enter into similar transactions (other than for the purpose of hedging currency exposure or managing duration). Form PF: Glossary of Terms, at 4, [online] available from http://www.sec.gov/rules/final/2011/ia-3308-formpf.pdf.

systemic trends in the hedge fund industry and assist in monitoring systemic risks to the U.S. financial markets.[140]

Nevertheless, there are categories for reporting information through Form PF depending on the fund's size, which can include three category types as follows:

1) Small fund advisers

Every fund manager is subject to register and disclosure of information to the authorities, as mentioned before. However, the Dodd-Frank Act created exemptions from SEC registration under the Investment Adviser Act, such as for any investment adviser who has less than $150 million in assets under management in U.S.[141] [142] Hence, every investment adviser, including a hedge fund manager, who has less than $150 million in AUM is free from both registration and disclosure. The reasons for exemption is because the regulators believe that regular disclosure of detailed systemic risk information may not be necessary due to the size of AUM because they are unlikely to pose this kind of risk.[143] As a result, such hedge fund managers are free from the disclosure requirement if they meet qualification of having less than $150 million in assets under management.

2) Mid-size advisers

Regulators provide an exemption from the registration requirement and disclosure requirement for any investment adviser who has less than $150 million in assets under management. Nonetheless, the Dodd-Frank Act also grants the SEC the authority to propose registration and examination procedures for investment advisers to "mid-sized private funds" by taking into account the size, governance, investment strategy and

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[140] Nabil Sabki and Nadia Sager, "Five lessons for Form PF", Practical Compliance & Risk Management For the Securities Industry.

[141] The Investment Advisers Act, Section 203(m)(1).

[142] The Dodd-Frank Act, Section 408 (1).

[143] See. Senate Committee Report, S. REP. NO. 111-176, at 74, ("The Committee believes that small private funds do not pose the same risk as the large private funds whose advisers are required to register with the SEC under this title. Also their activities are not interconnected with the global financial system, even the risk poses by them, such loss so not ripple throughout world markets but are borne by fund investors alone")

level of systemic risk posed by such funds.[144] Generally speaking, this regulation allows the regulators to require investment adviser who take advantage from this exemption to maintain such records and provide such annual or other information as the Commission determines necessary or appropriate in the public interest or for the protection of investors. The reason behind this is because a hedge fund may get involved in leverage transactions that can multiply its assets under management. For example, the manager has assets under management of $100 million. If he takes 2:1 leverage ratio, the manager will have $200 million regulatory assets under management (RAUM).[145] [146] The RAUM for each hedge fund is gross assets under management, without subtracting any borrowings, short sales or other forms of leverage. As a result, the authorities can consider the fund from their investment strategy and the size of the fund (RAUM) to determine whether the fund poses a systemic risk and shall provide for registration and examination procedures.

Once fund advisers are subjected to registration and examination as “midsize fund managers”, such advisers have to disclose and report information to the authorities. However, the frequency of reporting depends on the size of the funds. The mid-size private fund advisers are required to file Form PF annually as well as provide basic information about their funds.[147]

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[144] The Dodd-Frank Act, Section 408 (n).

[145] The RAUM is a new metric designed be the U.S. Securities and Exchange Commission to calculate gross assets under management for regulatory purpose. The RAUM calculation requires managers to report assets managed without deduction of any offsetting liabilities and it will represent all of the assets managed by a single manager, including assets of separate accounts and separate private fund.

[146] Amy or, “SEC Registration Plan May Apply to Midsize Hedge Funds” The Wall Street Journal, [online] available from: http://www.wsj.com/articles/SB10001424052970204138204576600741861488006

[147] See. Instruction 9 to Form PF.

3) Large size advisers

Hedge fund managers who have at least $1.5 billion in assets under management are qualified as large hedge fund advisers.[148] [149] A large hedge fund adviser is required to file Form PF and provide information about each hedge fund it managed during the reporting period.[150] The large hedge fund adviser has to report more specific information compared to a midsize hedge fund adviser and mutual fund manager, such as aggregate holding in different types of assets, the geographic distribution of their investments, and how much they rely on borrowed money, as well as the monthly value of portfolio turnover.[151] For instance, an adviser has to report for Question 44 and 45 on Form PF, which concerns the fund's total notional derivatives exposures and the net market-to-market value of its unclear derivatives positions and the value of the collateral and other credit support respect for those unclear positions. This information will help the regulators to monitor credit counterparties' unsecured exposure to hedge funds as well as the hedge fund's exposure and ability to respond to market stresses. Furthermore, large hedge fund advisers have to file Form PF more frequently than midsize hedge fund advisers and mutual fund managers. The large hedge fund advisers are required to file Form PF on a quarterly basis, compared to midsize hedge fund managers and mutual fund managers, who are only required to file a form on a yearly basis. As a result, large hedge fund advisers complete this additional reporting requirement under Form PF, which provides systemic risk information for a substantial majority of hedge fund assets while minimizing burdens on smaller hedge fund advisers that are less likely to pose systemic risk concerns.

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[148] Form PF, Section 2a.

[149] Securities and Exchange Commission, 17 CFR Parts 275 and 279, Release No. IA-3308; File No. S7-05-11.

[150] Form PF defines a "Large hedge fund adviser" generally as an adviser and its related persons who collectively, have at least $1.5 billion in hedge fund assets under management as of the last day of any month in the adviser's fiscal quarter immediately preceding its most recently completed fiscal quarter. See. Form PF Instruction, available from: http://www.sec.gov/rules/final/2011/ia-3308-formpf.pdf.

[151] Fraser Sherman, "Do hedge fund have to disclose holding?" Demand media, [online] available from: http://budgeting.thenest.com/hedge-funds-disclose-holdings-28208.html

Form PF affects hedge fund managers in many ways. First, this rule imposes a significant obligation on hedge fund managers to provide the regulators with ongoing oversight into their fund activities. Furthermore, hedge fund managers have to submit information that was previously considered confidential. Second, such information is not used for assessing systemic risk alone. Rather, it is used by the SEC to identify risks related to investor protection.

3.2.4.4 Confidentiality

The objective of the reporting requirement between a hedge fund manager and mutual fund manager is different. First, the purpose of a mutual fund manager disclosure requirement is to protect investors by requiring the mutual fund manager to disclose all material information, which might affect the investor's interest such as ownership, clients, investment adviser's business, business practices, affiliations, and any disciplinary events of the adviser or employees.[152] Also, that information is publicly available on the Investment Adviser Public Disclosure (IAPD) database, so every investor can have access to this database via the IAPD website and do due diligence before making an investment. [153]

By contrast, hedge fund managers are required to report a different type of information. The purpose of those disclosure requirements is mainly for market stability and to prevent systemic risk by requiring a hedge fund manager to file specific information such as the type of asset held, trading practices, investment positions, use of leverage, and counterparty credit risk exposure. That information is very sensitive to the financial market in many ways, which should be kept private.[154] As a result, Form PF elicits non-public information about the fund and their trading strategies. Public disclosure of that information could adversely affect the funds and their investors. The

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[152] The Securities and Exchange Commission, "Form ADV" [online] available from: http://www.sec.gov/answers/formadv.htm

[153] The Securities and Exchange Commission, "Investment Adviser Public Disclosure" [online] available from: http://www.adviserinfo.sec.gov/IAPD/Content/IapdMain/iapd_SiteMap.aspx

[154] The Securities and Exchange Commission, 17 CFR Parts 275 and 279, No. IA-3308; File No. S7-05-11

U.S. SEC is intent on not making such Form PF information to the public. Nevertheless, that information can be shared with other Federal departments or agencies for the purposes within the scope of their jurisdiction. However, that information must be maintained confidentiality at all times. In conclusion, the information collected on Form PF is used for enforcement action and to monitor any potential risk. Such information is not available to the public. Conversely, Form ADV for the mutual fund manager is used to protect investors and is publicly available for every investor.

3.2.5 Marketing the Fund

In the U.S., there is a regulation used to regulate fund marketing and advertising, as stated in Section 5 of the Securities Act; it prohibits offers of securities unless complying with strict disclose requirements imposed by Section 10 of the Securities Act. Nevertheless, the term “offer” is broadly defined under securities law to include any written communication designed to engender investor interest in a security, and also includes any mass communication intent on offering securities to investors. Hence, anyone seeking to publicly offer their securities must provide a prospectus and comply with the disclosure requirement.

The nature of mutual fund marketing usually engages mass communication and public offerings. Thus, it has to hold itself out and advertise. Accordingly, it has to comply with the law by providing a registered prospectus before offering to the public. Under the Securities Act Section 10, the mutual fund manager may satisfy their prospectus delivery requirements by providing an investor with a “summary prospectus.” The prospectus must provide investors with a summary of key information about a fund presented in a standardized sequence, such as the fund’s investment objective and goals, fees and expense, principal investment strategies, risks and performance, fund’s investment adviser, brief tax information, the share purchase and sale process including minimum initial investment requirements and procedures for redeeming shares. [155]

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[155] K&L Gates, “Advertising the Mutual Fund” [online] available from: http://www.klgates.com/files/Upload/DC_IM_05-Advertising.pdf

On the other hand, hedge fund managers launch their initial capital with relatively small amounts of capital, which is usually raised from friends and family. However, such interest used for raising capital is considered as securities.[156] Under the Securities Act of 1933, offering any securities in the U.S. is required to be registered with the SEC unless such securities meet an exemption from registration.[157] Nevertheless, they have to comply with the Securities Act if they decide to offer their securities publicly, which requires disclosure of specific information through the prospectus the same as the mutual fund manager. Also, general solicitation and general advertisement are not allowed when relying on this safe harbor rule. Normally, general solicitation and general advertisement are very broadly defined to include advertisement, article, notices or other communication published in a newspaper, magazine, or similar media, mass mailing, broadcasts over television or radio, materials contained on website available to the public, or email messages sent to a large number of previously unknown persons. This no general solicitation and no general advertisement requirement may be avoided under the JOBS Act. If the purchaser is limited to accredited investors and the issuer takes reasonable steps to confirm that the purchasers are accredited investors at the time of investment, this is another way to offer securities by using an exemption under Regulation D. However, existing safe harbors are also available. Thus, hedge fund managers can choose one of these options at their discretion to offer fund shares on a private placement basis.[158]

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- Private placement exemption

The private placement exemption allows hedge fund managers to raise capital from investors without any registration under the Securities Act Section 4(a)(2)[159] and

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[156] The definition of "security" is set forth in section 2(a)1 if the Securities Act of 1933 and includes limited partnership and limited liability company interests and other passive investment as "investment contracts."

[157] 15 U.S.C. § 77e.

[158] Eun Jip Kim, "Rethinking Hedge Fund Regulation: Focusing on the U.S., the U.K., and Korea, Indiana University school of Law-Bloomington, Page 91

[159] The Securities Act of 1933 Section 4(2).

Rule 506 of Regulation D[160], which is a safe harbor for issuers of securities to avoid the time consumption and costs involved in a registered offering.

Under the Securities Act Section 4(a)(2), any offering securities are exempt from registration "by an issuer not involving any public offering."[161] If any issuer offers unregistered securities to the public, it is subject to unlawful activities, whether directly or indirectly.[162]Also, there is an exemption standard that needs to be satisfied, as follows:

First, the manager cannot use public solicitation or advertise any interest to the market.

Second, the manager can offer or sell an interest to an unlimited number of "accredited investors" and up to 35 for "non-accredited investors". Furthermore, any non-accredited investor must be sophisticated, which means they must have sufficient knowledge and experience in financial and business matters to make them capable of evaluating the merit and risks of the investment.[163]

Third, the manager has to give non-accredited investors disclosure documents that are the same as those used in registered offerings. However, the manager can decide what information should be given to them so long as it does not violate the antifraud prohibition law. Moreover, the manager has to be available to answer any questions raised by the prospective purchaser. [164]

Moreover, an investment company advertising is regulated by a comprehensive regulatory scheme under the Securities Act of 1933 and the Investment Company Act

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[160] 17 C.F.R. 230.506.

[161] 15 U.S. Code § 77d (2).

[162] The Securities Act of 1933, Section 5.

[163] Ibid. See. Also 17 CFR 230.501 (i)(2).

[164] U.S. SEC, " Rule 506 of Regulation D" [online] available at: http://www.sec.gov/answers/rule506.htm

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of 1940. Under this regulation, every advertisement is held to the standard of a statutory prospectus unless they fall within certain exceptions.

Furthermore, the Investment Adviser Act also has a provision which focuses on one particular kind of advertising (i.e. performance advertising). Rule 206(4)-1 specifies certain types of advertisements as “fraudulent, deceptive, or manipulative.”

Usually, hedge fund managers seek to present their investment performance record to prospective clients to attract more investors. Hedge fund managers put their performance record in one of two ways: first, showing the performance of some or all the actual portfolio under management or, second, indicating the performance of a “model portfolio”. A model portfolio is, in effect, a fictional account established as of a certain date, which the hedge fund manager just manages for the client portfolio. As a result, he or she is subject to fraudulent, deceptive, or manipulative violations if any of the information given to the public contains any untrue statements of a material fact, or false and misleading statements.

Also, once a hedge fund manager offers their securities through “private offering”, there are no specific disclosure requirements for the offering documents. Most hedge fund managers provide written information to their investors in the form of a private offering memorandum. This document is referred to as both the prospectus and subscription agreement. The private placement memorandum (PPM) is a disclosure document which provides potential investors with the terms and conditions of a hedge fund. This document is similar to a business plan, except that this document focuses on the disclosure of facts rather than projected results. The private placement memorandum includes a discussion of the terms of the offering, the allocation of proceeds, and the risk factors inherent in the business and industry. Typically, the PPM contains all information about the fund, investment adviser, and the securities offered, as well as any other information considered to be material information by a potential investor. The PPM is accompanied by a subscription agreement and investor questionnaire. The subscription agreement is a contract to purchase a specified amount of securities at an agreed price, contains a statement that the investor has received and reviewed the PPM, is aware of the risk factors, and is a suitable investor. The investor

questionnaire elicits information about the investor's background, employment, and investment or business experience. It is used, in part, to confirm the investor's accreditation and sophistication.[165]

3.2.6 Investor qualifications

Both a hedge fund and mutual fund are different from each other. First, there is no investor qualification in a mutual fund. Hence, any individual investor can invest in a mutual fund. Investing in a mutual fund requires a small amount of money and fee; an investor can make an investment with a little amount of money. A mutual fund was designed for individual investors because it provides substantial protection standards, so every investor can ensure that they are protected. Furthermore, mutual funds are restricted to making investments in a certain amount and type of assets, which makes mutual fund investment safer than a hedge fund.

On the other hand, a hedge fund is a risky investment vehicle, so there is a concern about who can invest in a hedge fund because hedge fund investors do not receive the same protection standard as mutual fund investors. Mutual fund investors received protection since they receive an offer from the fund until the end of investment. In other words, the fund managers are required by law to provide and disclose all information accurately and verify it through the authorities for their investors. By contrast, hedge fund managers are not obliged by law to provide those documents and such documents are not verified by authorities before delivery to investors. Moreover, a hedge fund manager can decide what information to give to investors as long as it does not violate the antifraud prohibitions.[166] The reason is that the relationship between hedge fund investors and the hedge fund is as shareholder or partnership. Thus, this engagement is not subject to securities law. Furthermore, hedge fund investment requires high initial capital. The hedge fund investor also has to pay a high fee. As a result, the regulator has set a qualifications for an investor who can invest in a hedge

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[165] Management Services Group, "Hedge fund offering Documents" [online] available from: http://www.capitalmanagementservicesgroup.com/startahedgefund/offeringdocuments.html

[166] U.S. Securities and Exchange Commission, "Rule 506 of Regulation D" [online] available from: http://www.sec.gov/answers/rule506.htm

fund, called “accredited investor” and “sophisticated investor”.[167] As a result, hedge funds are available only for a particular type of investor. It also restricts other investors from investment to protect them from financial loss in hedge fund investment.

As a result, hedge funds are available for qualified investors or accredited investors only, which restrict other investors from investing in the hedge fund to protect them. Under Regulation D, the definition of “accredited investor” is any person who meets any of the categories such as “any natural person whose individual net worth or joint net worth with that person's spouse exceeds $1,000,000.”[168] or “Any natural person who had an individual income in excess of $200,000 in each of the two most recent years or joint income with that person's spouse in excess of $300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year;”[169]

An accredited investor also includes some entities. These include an entity that is a corporation, partnership, Limited Liability Company or business trust that was not formed for the specific purpose of investing in the fund and that has total assets of more than $5 million. However, the manager will be required to “look through” the entity to the beneficial owners of the entity and each owner must be an accredited investor if the entity was formed for the specific purpose of investing in a hedge fund.[170] Alternatively,

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[167] An accredited or sophisticated investor is an investor with a special status under financial regulation laws. The definition of an accredited investor, and the consequences of being classified as such, vary between countries. Generally, accredited investors include high-net-worth individuals, banks, and other large corporations, who have access to complex and higher-risk investments such as venture capital, hedge funds and angel investments. Moreover, the purpose of the status designation is to protect potential investors from risk. The assumption underlying accreditation is that individuals or organizations who qualify will have sufficient financial sophistication to understand and take on the risks associated with certain investment offerings. Laws may require that some types of financial offerings may only be made to accredited investors. See. Lufrano Law, LLC, “The SEC’s Accredited-Investor Standard is Long Overdue for an Overhaul” [online] available from: http://www.lufranolaw.com/blog/-the-secs-accredited-investor-standard-is-long-overdue-for-an-overhaul

[168] 17 C.F.R. 230.501 (a) (5).

[169] 17 C.F.R. 230.501 (a) (6).

[170] Scott J. Lederman, “Hedge fund regulation” page 4-5.

another type of investor is deemed to have sufficient investing experience and knowledge to weigh risks and merits of an investment opportunity. These investors include banks, insurance companies, pension funds, investment companies, etc. It is necessary to ensure that each hedge fund investor fully acknowledges that they invest in a risky investment vehicle. Also, each of them can take a financial loss from hedge fund investment. More precisely, under Regulation D, accredited investors are automatically deemed sophisticated regardless of whether they are sophisticated or not. Thus, there is no need to protect them through mandated disclosure. This is a precondition for hedge fund managers to comply with and satisfy the threshold conditions. That is the reason a hedge fund can be exempted from the registration requirement.

As a result, the investor is an accredited investor if the manager can offer or sell an interest in the private placement and have no obligation to register such interest as securities.[171]

Furthermore, hedge fund managers have a responsibility to take reasonable steps to verify purchasers of securities sold in any offering. In regard to the accredited investor by income, the manager has to review any Internal Revenue Service form that reports the purchaser's income for the two most recent years. Moreover, obtaining written representation from the buyer that he or she have a reasonable expectation of reaching the income level necessary to qualify as an accredited investor.[172]

For the accredited investor by net worth, the manager has to review one or more documents such as bank statements, brokerage statements, and other statements of

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[171] 15 U.S. Code § 77e "(a) Sale or delivery after sale of unregistered securities

Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly—

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or

(2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale."

[172] 17 C.F.R. 230.506 (b) (2) (ii).

securities holding, certificates of deposit, tax assessments, and appraisal reports issued by independent third parties.[173]

According to the anti-money laundering law and the investment adviser code of conduct, which requires a hedge fund manager to ensure that each investor is not prohibited, a hedge fund manager has to verify each investor's status before accepting any investment.

In conclusion, hedge fund managers are responsible for verifying each investor status and whether they are qualified to make an investment or prohibited by law.

3.2.7 Prohibited activities

The Investment Adviser Act Section 206 is the general anti-fraud provision governing investment advisers. Advisers who are exempt from registration are still subject to some anti-fraud provisions. Hence, every investment adviser, including a mutual fund manager and hedge fund manager, is subject to whether such investment advisers are required to register with the authorities or not. Under the anti-fraud provision, both a hedge fund manager and mutual fund manager are prohibited from engaging in fraudulent, deceptive or manipulative activities, the same as investment advisers. Also, they are prohibited to engage, whether by direct or indirect transactions, in acts that are fraudulant upon any client or prospective client. It also prohibits misstatements, as well as omissions of material facts.[174] Moreover, under Section 206(1) and (2) of the Investment Advisers Act, it is stated that it is unlawful for any investment adviser to utilize any device, scheme or artifice to defraud any client or prospective client. The investment advisers must also refrain from engaging in any transaction, practice or course of business that operates as a fraud or deceit upon any client or prospective client. This section of the Investment Adviser Act is the foundation of the fiduciary duty owned by the investment adviser to their clients. For instance, it would be deceptive for an investment adviser to solicit any investors with promises of

[173] Ibid.

[174] A fact is deemed material if there is a substantial likelihood that a reasonable investor would consider it to be important. See. teadman v. SEC, 603 F. 2d 1126, 1134 (5th Cir. 1979), aff'd 450 U.S. 91 (1981)

a guaranteed return on certain investments or false statement about the firm's track record. Also, it would be fraudulent or deceptive for investment advisers to assure prospective clients that an investment is risk-free. [175] [176] [177]

In conclusion, this rule applies to both registered and unregistered investment advisers, so even hedge fund managers that do not register still have to comply with this rule. This rule prohibits false or misleading statements to both current and prospective investors. It also covers any actions taken to be an investment adviser on an investment pool managed by such an investment adviser, even if the fund is not currently offering, selling or redeeming securities.[178] Furthermore, this anti-fraud provision makes it illegal for any investment adviser to make any misstatement, omission of a material fact or conduct any activities which are considered fraud.

3.3 Hedge Fund Managers under U.K. Regulation

3.3.1 Background

The center of the hedge fund business in Europe is in the U.K., especially London. As of the end of 2012, almost 80% of hedge fund assets in Europe were managed by U.K.-based managers[179], which support the fact that London is the first place for the hedge fund business in Europe and also the second place worldwide. The explanation for the reason why most of the hedge fund managers in Europe and worldwide are willing to be based in the U.K., especially London, is because due to local expertise, the proximity of institutional clients and the global market, along with

[175] The U.S. Investment Adviser Act, Section 206.

[176] Les Abromovitz, "Anti-Fraud Provisions of the Investment Advisers Act" [online] available from: http://www.thinkadvisor.com/2012/01/01/anti-fraud-provisions-of-the-investment-advisers-a

[177] Kathleen E. Lange, "The New Antifraud Rule: Is SEC Enforcement the Most Effective Way to Protect Investors from Hedge Fund Fraud?" Fordham Law Review, vol. 77.

[178] The U.S. Securities and Exchange Commission, "Prohibition of fraud by advisers to certain pooled investment vehicle" [Release No. IA-2628; File No. S7-25-06]

[179] "2013 Preqin Global Hedge Fund Report", Figure 2.3, [online] available at: http://www.preqin.com/docs/samples/The_2013_Preqin_Global_Hedge_Fund_Report_Sample_Pages.pdf

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an established financial service industry. Lastly, a favorable regulation environment makes it attractive[180], which is one of the reasons to be discussed.

All securities activity is regulated by the authorities. Everyone willing to operate a securities business must be authorized before operating such a business. In the U.K., one of the regulated activities is the fund manager business. Thus, anyone who is going to be a fund manager, whether hedge fund manager, mutual fund manager or private fund manager, must be authorized. In the U.K., the regulation used to oversee hedge fund managers is the same regulation used to oversee other fund managers. In another words, hedge fund managers in the U.K. have to be authorized the same as other fund managers. Furthermore, such authorization processes for fund managers have no exemptions available, so every fund manager in the U.K. is required to be authorized. Compare this to U.S. regulation, which provides an exemption for any fund manager who meets the exemption qualifications.

In the U.K., there is the Financial Conduct Authority (FCA), which is a financial regulatory body. However, it operates independently of the U.K. government. The FCA duty is to regulate financial firms and provide services to consumers while maintaining the integrity of the U.K.'s financial markets.[181]

The Financial Conduct Authority (FCA) has the authority to regulate conduct related to the marketing of financial products and also has the power to investigate organizations and individuals.[182] Further, the FCA has the authority to supervise every fund manager, whether hedge fund or mutual fund, operating in the U.K. The role of the FCA is to collect data from the funds and fund managers to inform its supervisory activity, with the purpose to ensure that the market works well and promotes market

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[180] HFMWEEK Special Report "How to start a Hedge fund in The EU 2013" [online] available at: https://www.hfmweek.com/__data/assets/pdf_file/0005/41828/HFMHow2EU-reduced.pdf

[181] "about FCA" [online] available from: http://www.fca.org.uk/about/what

[182] Ibid.

integrity.[183] Also, the FCA has a duty to assess the systemic risk posed by a hedge fund and develop potential policy measures to evaluate the risk.

Under the U.K. regime, there is the Alternative Investment Fund Managers Directive (AIFMD). The AIFMD is a European financial directive designed by EU policy makers as a comprehensive plan for the oversight of alternative investment fund managers (AIFMs) operating in the EU. The directive was introduced after the global financial crisis, seeking to address regulatory gaps and reduce systemic risk in the alternative investment industry. The Aim of the AIFMD is to enhance supervisory practices among European Economic Area (EEA) competent authorities to support timely and pre-emptive action to prevent systemic risk in the European financial system. Secondly, to improve investor protection by imposing new depositary standards and enhanced transparency through new investor disclosure rules and mandatory reporting to competent authorities. Third, to foster efficiency and cross-border competition by deregulating political barrier and creating a level playing field through harmonized rules on an EEA-wide passport for full-scope EEA AIFMs to market and manage alternative investment funds.[184]

Also under the U.K. regime, a hedge fund can be structured as a limited company, limited partnership or even an offshore fund depending on the region of the investor. Under U.K. law, the limited company or limited partnership structure provides several benefits regarding equity, which means easily moving equity within the fund. Also, this structure can avoid complicated tax issues so that the hedge fund manager would have greater management flexibility.[185]

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[183] Financial conduct Authority "Hedge Fund Survey March 2014" [online] available from: http://www.fca.org.uk/static/documents/hedge-fund-survey.pdf

[184] The Financial Conduct Authority, "Alternative Investment Fund Managers Directive (AIFMD)" [online] available from: http://www.fca.org.uk/firms/markets/international-markets/aifmd

[185] Paul Milnes, "Structuring a hedge fund and fund management company: The legal issues – Part two" [online] available from: http://www.hedgethink.com/regulation/structuring-a-hedge-fund-and-fund-management-company-the-legal-issues-part-two/

3.3.2 Hedge fund manager and mutual fund manager registration

In the U.K., anyone who intends to conduct regulated activities such as managing the fund, whether a mutual fund or hedge fund, must be authorized by the Financial Conduct Authority (FCA). Even a manager domiciled outside the U.K. is subject to U.K. regulation. For example, an offshore manager contemplates conducting "regulate activities". In the U.K., the marketing is more likely to be subjected to U.K. regulation, such as marketing the offshore funds which they manage to U.K. investors or trading the fund assets. By contrast, there is no exemption available under the U.S. regime for hedge fund managers in the U.K., because U.S. hedge fund managers may avoid investment adviser registration with the SEC by having fewer than 15 clients in the preceding year and do not hold themselves out to the public.

Under the Financial Service and Market Act Article 22, the type of activities which are regulated are determined by this act. Regulated activity is mostly related to investment. The hedge fund and mutual fund businesses are obviously related to investment, which subjects them to regulated activities. According to Article 19, "no person may carry on a regulated activity in the United Kingdom, unless he is an authorized person or exempt person." Thus, hedge fund managers and mutual fund managers under Article 19 are required to be authorized before operating their business.

Article 40 determines the application for permission and allows individuals, partnerships, cooperatives, and unincorporated associations who are willing to operate regulated activities to file a request for permission. Under Schedule 6 of the FSMA, threshold requirements for authorization are provided, including the applicant's legal status and location of the offices, close links, and financial situation. Furthermore, the petitioner must comply with the threshold in Article 41-49, which gives the power to authorities to require additional information necessary such as asset information, and information about the related person. Moreover, such a person may not prevent the authorities from taking such steps as it considers are necessary about a particular authorized person to secure its regulatory objective for the protection of consumers. As a result, every mutual fund manager is subject to "full scope oversight", which requires every mutual fund manager to disclose information fully to the authorities.

However, hedge fund managers are subject to the Alternative Investment Fund Managers Directive (AIFMD), which requires being authorized the same as a mutual fund manager. Nonetheless, the AIFMD provides much lighter regulation for alternative investment fund managers. By having total assets under management of alternative investment fund not exceeding either €100m; or (ii)where the AIFs managed are all unleveraged, and all have a lock-in period of at least five years, €500m.[186] Nevertheless, even if such hedge fund managers met the qualification as a small alternative investment fund manager, such AIFMs are still subject to a registration requirement and not more onerous authorization and some other conditions.[187] [188] Under the registration requirement, the small registered AIFMs would need to apply to the FCA for entry to the register and also have to provide a certain type of information such as investment strategies of the alternative investment fund they manage. Furthermore, it requires providing information to the FCA on the main instruments in which they are trading and on the principal exposures and most important concentrations of the AIFs that they manage and a summary regulatory business plan.[189] [190] However, such a manager who takes advantage from this registration will not benefit from the AIFMD's pass porting provisions. To do so, the AIFMD would need to comply with full authorization.

On the other hand, the AIFMs managing Alternative Investment Funds above the threshold of assets under management set out in Article 3 of the Alternative Investment Fund Managers Directive (AIFMD) would need to be authorized by the FCA and be subject to the full requirements of AIFMD. This type of firm is referred to

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[186] The Alternative Investment Fund Managers Regulations 2013, Article 9.

[187] Jonathan Rogers, Alix prentice, The Alternative Investment Fund Managers Directive ("AIFMD"), [online] available from: http://united-kingdom.taylorwessing.com/fileadmin/files/docs/The-Alternative-Investment-Fund-Managers-Directive.pdf

[188] The Alternative Investment Fund Managers Regulations 2013, Article 10.

[189] Simon Thomas, Alex Amos, "THE ALTERNATIVE INVESTMENT FUND MANAGERS DIRECTIVE" [online] available from: http://www.macfarlanes.com/media/1407/the-alternative-investment-fund-managers-directive-the-uks-proposed-regime-for-sub-threshold-private-equity-real-estate-and-hedge-fund-managers.pdf

[190] The Alternative Investment Fund Managers Regulations 2013, Article 11.

as a 'full-scope UK AIFM'.[191] Once such fund managers are subject to the full scope of the U.K. AIFM, they have an obligation to fully report on a quarterly basis to the FCA.[192]

Offenses for an unauthorized person who commits a regulated activity as stated in Articles 23-25 and 26-30 are punishable. A person who contravenes the general prohibitions stated in Article 19 is guilty of an offense and liable to incarceration.[193] Alternatively, a person who describes himself as an authorized person or as an exempt person about the regulated activity or behaves or otherwise holds himself out in a manner which indicates to be understood as an authorized person or exempt person is also guilty.

3.3.3 Disclosure requirements

Under the U.K. regime, both hedge fund managers and mutual fund managers are regulated in the same way. Normally, hedge fund managers and mutual fund managers are subjected to the mandatory disclosure requirement, which requires both fund managers to make certain information available to investors before the investor makes investment decisions. Under the Financial Service and Market 2000 Act and the Alternative Investment Fund Manager Directive (AIFMD), both hedge fund managers and mutual fund managers are required to provide general information to investors, such as investment strategy and objective, type of assets, investment restrictions, valuation and pricing procedure, investment techniques, fees, expenses, latest annual report, latest net asset value, and historical performance.[194] [195] Moreover, the Financial Service and Market Act, Article 84-87, requires every fund manager to provide a prospectus and publish those prospectuses before offering. Moreover, it is unlawful to make a public offering before publishing those prospectuses.[196] Also, such a fund

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[191] The Financial Conduct Authority, UK AIFMs [online] available from: http://www.fca.org.uk/uk-aifms

[192] Full-scope UK AIFM, SUP 16.18.5 R.

[193] The Financial Services and Market Act 2000, Article 23.

[194] The Alternative Investment Fund Manager Directive, Article 23, 24.

[195] The Financial Services and Market Act 2000, Article 79, 80.

[196] The Financial Services and Market Act 2000, Article 84-87.

manager is required to disclose any material changes to the investment after the investment is made. However, it is necessary to require a hedge fund manager to disclose more information which might allow each investor be able to assess the risk of investment regarding the complexity and risk of hedge fund investment. As a result, there are additional disclosures required for a hedge fund manager under the Alternative Investment Fund Manager Directive (AIFMD) Article 24 to provide information such as liquidity arrangements, the current risk profiles, the total amount of leverage employed, and any changes to the maximum level of leverage.

As illustrated above, both a hedge fund manager and mutual fund manager are subject to the same mandatory disclosure requirement before offering their fund to investors.[197] However, they are subject to different provisions even if the information required is mostly the same. Generally speaking, mutual fund managers are subject under the Financial Services and Market Act. By contrast, hedge fund managers are subject under the Alternative Investment Fund Manager Directive (AIFMD). The AIFMD is a provision used to supervise practices in the European Economic Area (EEA). It allows the fund manager to market within all countries that are a part of the European Union. It also introduces the concept of a simplified prospectus, which is intended to provide more accessible and comprehensive information in a simplified format to assess cross-border marketing within the EEA. Furthermore, it also resolves the differences in the laws of each country by introducing the AIFMD, which applies to every country in the EU.

Compared to the U.S. regime, there is no disclosure exemption or any private placement exemption available for U.K. hedge fund managers to rely on. Under the

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[197] This mandated disclosure requirement is incompatible with the hedge fund regime in essence because it is a private market that only certain presumable sophisticated investors (who are presumable able to protect themselves) are allowed access to. Despite the issues there is no clear rationale for why both markets should be treated the same. See. Eun Jip Kim, School of Law Bloomington “Rethinking Hedge Fund Regulation Focusing on the U.S., the U.K., and Korea. Chapter V, Part B.

U.S. regime, it provides a safe harbor for hedge fund managers. Hence, U.K. hedge fund managers are subject to the mandatory disclosure requirement.[198]

3.3.4 Reporting requirements

Under the U.K. regime, every fund manager has an obligation to file a report with the authorities to allow the authorities to be able to monitor risk and unlawful activity in the financial market. Under the Financial Service Market Act Section 218, a mutual fund is required to make a report to the authorities once a year. The purpose of this requirement is to require mutual fund managers to submit their annual report and accounts, and the annual report and account of their fund's activities to the FCA. This information is used in the monitoring of the fund's operations.[199] According to the Disclosure Rules and Transparency Rules (DTR), the annual report must include the financial statements, management report. Furthermore, it also requires mutual fund managers to provide a management report that includes a risk assessment report, a comprehensive analysis of development and performance of the fund.[200]Moreover, such a report must be kept for three years.[201]

Article 165-167 of the FSMA gives power to the authorities to gather information. The authorities may require authorized persons to provide specified information, information of a specified description or produce specified documents or documents of a specified description. Moreover, such information or documents must be provided or produced before the end of a reasonable period. Also, the authorities can make an appointment to investigate such authorized persons if there is a good reason to do so. The investigating authority may appoint one or more competent persons to conduct an investigation on its behalf according to Articles 167 and 284.

Hedge fund managers are also subject to the reporting requirement. Hedge fund managers are subject under the Alternative Investment Fund Managers Directive,

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[198] Ibid.

[199] The Financial Conduct Authority, "Annual report and Accounts" [online] available from: https://www.handbook.fca.org.uk/handbook/SUP/16/7A.pdf

[200] Disclosure Rules and Transparency Rules, 4.1.5R.

[201] The FCA Handbook, SUP 13.11.

which requires complying with the AIFMD reporting form known as Annex IV to the AIFMD Level 2 Regulation.[202] Under the AIFMD reporting requirement, hedge fund manager are required to report to the relevant regulator of various information relating to both the manager and the fund. For example, the principle types of investments it manages and where those investments are located or traded, and the total AUM of all its fund, including details of its investment strategy, principle exposure and concentrations, detailed information on exposure and risk profile, the result of risk and liquidity, and leverage information.

However, the Alternative Investment Fund Manager is also subject to the ongoing reporting requirement to the authorities. The frequency of the reporting may vary depending on the size of funds the AIFM manages. For instance, small firms with assets under management of between EUR 100 million and EUR 1 billion are required to report to the authorities on a biannual basis, while bigger firms with assets under management of EUR 1 billion or more are required to report on a quarterly basis.

The frequency of reporting can be categorized as follows:

- On a quarterly basis by Alternative Investment Fund Manager, who manages portfolios of alternative investment funds whose assets under management in total exceed EUR 1 billion, for each of the EU AIFs they manage. Moreover, any AIFMs whose assets under management, including any assets acquired through the use of leverage, in total exceed EUR 500 million.
- On a biannual basis by AIFMs managing portfolios of AIFs whose assets under management in total exceed EUR 100 but are less than EUR 500.
- On an annual basis by a small registered AIFM in respect of each unleveraged AIF under their management which, by its core investment policy, invests in non-listed companies and issuers to acquire control.[203] [204]

[202] The Alternative Investment Fund Managers Directive, Article 110 (Level 2 Regulation).
[203] The Financial Conduct Authority, Sup 16.18.4
[204] The Financial Conduct Authority, Sup 16.18.7 D.

Furthermore, the authorities may deem it appropriate and necessary under the Level 2 Regulation to require all or part of the information to be reported on a more frequent basis.[205]

3.3.5 Marketing the Fund

In the U.K., there is the Financial Services and Markets Act (FSMA), which has the rule to prohibit anyone from acting "in the course of business to communicate an invitation or inducement to engage in investment activity" unless they meet the condition or exemption.[206] These rules are used to control an authorized person to promote the funds provided that the content of the communication be approved by the authorized or approved person first. The FSMA has defined a "financial promotion", as stated in Article 238, as "promotion otherwise than to the general public include promotion in a way designed to reduce, so far as possible, the risk of participation by a person for whom participation would be unsuitable." Furthermore, it has defined communication broadly under Article 238 to include any communication used to promote funds. It also includes any communication made from outside the U.K. to control any communication from an offshore fund. As a result, an unauthorized person is not allowed to promote, invite, or induce their fund to the general public. However, such a person can rely on the exemption that they have to offer their fund only through private placement.

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As a result, both hedge fund managers and mutual fund managers are subject to the marketing regulation, requiring them to be authorized before making a public offering. Hence, an unauthorized fund manager includes an unauthorized hedge fund manager, who is not allowed to communicate an invitation or engage in marketing or promotional activity in the U.K. unless they rely on exemptions because offering circular and other marketing material for operations of the fund may constitute financial promotion under the FSMA.[207] In particular, a hedge fund manager under the FSMA

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[205] The Financial Conduct Authority, Sup 16.18.4
[206] The Financial Services and Markets Act 2000, Section 21, 238.
[207] The Financial Services and Markets Act 2000, Section 325.

Article 238 (5)[208] can rely on the exemption if such marketing is not a general public offering. Moreover, the Conduct of Business Sourcebook (COBS) 4.12R provides an exemption from the general prohibition of fund promotion under FSMA Article 238. It provides a safe harbor rule that is not a breach of the FSMA Article 238 for hedge fund managers to market the fund if taking reasonable steps to ensure that they market fund interests to only specified categories of investor or to any persons reasonably regarded as being comparable to those in the specified categories.[209]

As a result, it is critically important for hedge fund managers to only market hedge funds to particular categories of professional investors if they want to rely on this exemption. Nevertheless, hedge funds are typically domiciled offshore, so they are not allowed to market to the general public. Only U.K.-based hedge funds or offshore-based hedge funds that are authorized or recognized by the FCA are eligible for the exemption that allow them to market to the general public under the FSMA.[210]

Also, the AIFMD provides a benefit for hedge fund marketing. Once a hedge fund manager has passed the conditions for authorization in one EU member state, he is permitted to market EU AIFs managed in any member state of the EU without further authorization. This so-called "passport" is currently available only to EU AIFMs. To benefit from the passport regime, such AIFMs have to be "full scope authorized AIFM",

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[208] See also Conduct of Business Sourcebook, art. 4.12.1R, [online] available from: http://fshandbook.info.FS/html/handbook/COBS/4/12 (providing some exemptions for an authorized person to market or promote unregulated fund like hedge funds.)

[209] The Conduct of Business Sourcebook, 4.12.1 "(1) A firm may communicate an invitation or inducement to participate in an unregulated collective investment scheme without breaching the restriction on promotion in section 238 of the Act if the promotion falls within an exemption in the table in (4), as explained further in the Notes.

(2) Where the left-hand column in the table in (4) refers to promotion to a category of person, this means that the invitation or inducement:

(a) is made only to recipients who the firm has taken reasonable steps to establish are persons in that category; or
(b) is directed at recipients in a way that may reasonably be regarded as designed to reduce, so far as possible, the risk of participation in the collective investment scheme by persons who are not in that category.
(3) A firm may rely on more than one exemption in relation to the same invitation or inducement."

[210] The Financial Services and Markets Act, Article 238, 264, 270, 272.

which allows them to take advantage of the EU-wide marketing passport.[211] The purpose of the "passport regime" is to harmonize fund marketing within EU member states. Under the AIFMD, there are two ways to market their fund to European investors: First, the passport regime can be used if a fund promoter has an Alternative Investment Fund Manager (AIFM) based in an EU member state with a European-domiciled Alternative Investment Fund (AIF); Second, Non-EU structures may continue to be distributed in various European countries using National Private Place Rules (NPPRs) for as long as they remain available for use.[212]

3.3.6 The impact of the AIFMD on hedge fund manager regulation

The U.K. has a special regulation compared to the U.S. because the U.K. has tried to regulate the hedge fund industry in a harmonious way within the E.U. and worldwide. The AIFMD was partially implemented in all E.U. member states starting on July 22, 2013.[213]

The Alternative Investment Fund Managers Directive is a proposed regulatory and supervisory framework for alternative fund managers (AIFMs) in Europe. The proposal provides more transparency for investors and regulators associated with alternative investment funds. Its aim is to enhance supervisory practices among EEA competent authorities to support timely and pre-emptive action to prevent market instability and the build-up of systemic risk in the European financial system. Second, it improves investor protection by imposing new depositary standards and enhanced transparency through new investor disclosure rules and mandatory reporting to competent authorities.[214]

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[211] Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011, Article 31- 33

[212] PWC, "Distributing our knowledge fund distribution: UCITS and Alternative Investment Funds (AIFs) [online] available from: http://download.pwc.com/ie/pubs/2014-pwc-ireland-distribution-knowledge-12-05-2014-1.pdf

[213] "Alternative Investment Fund Managers Directive (AIFMD)" [online] available from: http://www.fca.org.uk/firms/markets/international-markets/aifmd

[214] Ibid.

Under the AIFMD, E.U. member states are required to transpose the AIFMD into their national regimes. The AIFMD provides the same comprehensive regime among the E.U. member states, which includes alternative investment funds (whether E.U. based or not), their managers (whether domiciled in the E.U. or not), their affiliated service providers (such as depositories), and the marketing of such funds. Also, the AIFMD is partially subject to disclosure and other reporting requirements unless they apply for authorization by directive to manage E.U.-based alternative investment funds or market the funds under the so-called "passport regime".[215]

For an offshore fund, there are several conditions which must be met before marketing or offering the fund to E.U. investors. First, the relevant E.U. member state must have a private placement regime in place to accommodate offshore fund marketing. Second, an offshore AIFMD must comply with disclosure and transparency requirements under the AIFMD. Third, a cooperation or information sharing arrangement must be made by the regulators of the E.U. member states' regulators, the home country regulator, and the regulator where the funds are domiciled (in cases where the jurisdiction of the offshore AIFM and offshore fund are different). Lastly, the home country of the offshore AIFMD must not be listed as a "Non-Cooperative Country or Territory".[216]

Furthermore, the AIFMD requires both the E.U. AIFM and non-E.U. AIFM to disclose and report obligations to investors before they make an investment decision, which includes a side letter or side pocket arrangement[217] and any material changes to

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[215] "ESMA guidance: AIFMD passport arrangements valid even where a member state is late implementing the Directive" [online] available from: http://www.outlaw.com/articles/2013/september/esma-guidance-aifmd-passport-arrangements-valid-even-where-a-member-state-is-late-implementing-the-directive/

[216] "High-risk and non-cooperative jurisdictions" [online] available from: http://www.fatfgafi.org/topics/high-riskandnon-cooperativejurisdictions/3

[217] A Side pocket "A type of account used in hedge funds to separate illiquid assets from other more liquid investments. Once an investment enters a side pocket account, only the present participants in the hedge fund will be entitled to a share of it. Future investors will not receive a share of the proceeds in the event the asset's returns get realized".

the investment after they invest. Also, the AIFMs are subject to continuous reporting requirements to existing investors after the investment. It also includes the illiquid asset's ratio in the fund portfolio, any special arrangement, the risk of the fund, and the amount of leverage employed.[218] Also, an AIFM is subject to an "ongoing reporting requirement", which imposes the frequency of reporting dependent on the size of the fund. For instance, small firms with assets under management between 100 million Euros and 1 billion Euros are required to report to the relevant regulator on a half-yearly basis, while big firms with assets under management of 1 billion Euros or more are required to report on a quarterly basis.[219]

3.4 Hedge funds under South Korea regulation

3.4.1 Background

In Korea, the Financial Services Commission (FSC) is responsible for financial policy and supervision. The main duty of the FSC is to supervise, inspect and sanction financial institutions, as well as issue regulatory licenses and approval to financial institutions.[220]

A Korean hedge fund used to be in the form of a private fund or qualified purchaser fund scheme under the old Korea fund regime. However, it did not provide any safe harbor to make a hedge fund unique. Because of some restrictions, for instance, a leverage transaction such as money borrowing, speculative derivative transaction, and short sales was legally barred. What is more, over 50% of the fund assets must be invested in companies subject to restriction.

A new hedge fund regime was introduced in September 2011 by amending the Enforcement Decree to the Financial Investment Services and Capital Market Act

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[218] "European Union (Alternative Investment Fund Managers) Regulation 2013" Part3 Chapter 5 "Fund transparency"

[219] "Guidelines on reporting obligations under Article 3 and Article 24 of the AIFMD" [online] available from: http://www.esma.europa.eu/system/files/2013-592_consultation_paper_on_esma_guidelines_on_aifmd_reporting_for_publication.pdf

[220] "About FSC" [online] available from: http://www.fsc.go.kr/eng/new_about/whatwedo.jsp?menu=01

(FSCMA). According to the growing demand for an alternative vehicle with different approaches from traditional investments and the increased need to invest in new growth engines, Korean financial regulators passed reforms to introduce the hedge fund in Korea. The reforms provided new regulation on privately-offered collective investment funds for qualified investors; it was especially revised for introducing the hedge fund in Korea by giving wider discretion to asset management firms and strengthening regulations, such as reporting duties.[221] [222]

Under the South Korean regime, every fund manager is considered a securities business, which has to be authorized by the proper authorities, who also have oversight. Hedge fund managers and mutual fund managers in Korea are subject to regulatory requirements, which have to registered or licensed before operating a business. Also, those fund managers also have to comply with the law related to mandatory reporting obligations on their operation strategies and derivatives deals, provide information necessary to enhance investor protection and prevent systematic risks. Hence, a fund manager has to report primary management strategy, the type of investment assets, the use of leverage, and the state of derivatives every quarter. Also, fund managers are restricted from advertising their name and investment performance.[223]

The reason the Korean government was determined to allow Korean-domiciled hedge funds and managers, while many other countries around the world tried to regulate the hedge fund industry more tightly, is because of the unique market circumstances surrounding the Korean hedge fund market. Under the Korean regime, offshore hedge funds had also been available to Korean investors through discretionary investment management accounts or specified money trusts. Thus, there are four different alternatives such as fund of funds, fund of hedge funds, discretionary investment management accounts, and specified money trusts. Also, the direct sale of

[221] Warren Park and Seonghak Ahn, Hana Institute of Finance, “Building a Hedge fund industry in Korea: Issues and concerns” [online] available from: http://www.eurekahedge.com/NewsAndEvents/News/102/January_2012_HanaIF_Building_a_Hedge_Fund_Industry_in_Korea_Issues_and_Concerns

[222] Heejin Noh, “Strategies to Develop Korea’s Hedge fund Regulations”

[223] Ibid.

an offshore hedge fund to certain professional investors had been available to Korea investors to access offshore hedge funds during the time when a Korea-domiciled hedge fund had been strictly prohibited. What is common among the four alternatives is that there is a market intermediary or third party fiduciary-like an investment adviser or a trustee between offshore hedge funds and Korea investors. No direct contact between them is permitted under the Financial Investment Services and Capital Market Act (FSCMA).[224]

3.4.2 Hedge fund manager licensing

Under the Financial Investment Services and Capital Market Act (FSCMA), any person is required to obtain a license if he/she intends to conduct fund management or marketing business in Korea.[225] Compare this to U.S. regime, where there is no private adviser exemption for licensing purposes available in Korea, even when such a fund manager only targets qualified investors.

According to the Financial Investment Services and Capital Market Act (FSCMA), Article 12 and 18, it required anyone willing to engage in the investment advisory business to register with the authorities and provide information stated in Section 18 of the Financial Services Commission. Furthermore, such an investment advisor must maintain the requirement for registration, which they have to continue to meet the requirements of Article 18. Lastly, Section 17 prohibits anyone from engaging in a investment advisory business or related business without registration. As a result, both hedge fund managers and mutual fund managers are subject to the same licensing requirement.

Nevertheless, the Korean hedge fund market was introduced by the government, not by market participants. At that time, local firms in Korea demonstrated insufficient progress and advancement in their business practices and gained little experience or expertise in hedge fund and prime brokerage services. As a result, the Korean

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[224] Eun Jip Kim, “Rethinking Hedge Fund Regulation: Focusing on the U.S., the U.K., and Korea” Indian University School of Law-Bloomington, Page 160.

[225] The Financial Investment Services and Capital Market Act, Article 11, 12.

government made an effort to introduce a brand-new hedge fund market in Korea by encouraging Korean-domiciled companies to play a more active role in investing in emerging companies with growth potential. The Korean government also tried to attract foreign hedge fund managers to Korea to help built up the local hedge fund market. The Korean government provided incentives for foreign hedge fund managers by imposing less stringent licensing requirements compared to local hedge fund managers and securities firms or asset management companies.[226]

As a result, not everyone under the Korean regime is allowed to apply for the license, but only certain licensed entities such as securities firms, investment advisers, asset management companies, and foreign hedge fund managers who satisfy all the qualifications can apply for a license. Moreover, such applicants must meet the qualifications standards, such as being a professional with more than two years of experience in securities investment and complete training provided by the Korea Financial Investment Association (KOFIA), professionals with more than two years' experience in operating an overseas hedge fund[227], management capability, track record, and expert staffing. Normally, minimum paid-in capital for a fund manager would be 6 billion KRW, which is based on equity capital, assets under management, performance, and other factors. All these requirements must be satisfied by a fund manager.[228]

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[226] It may be understood as a policy decision be the Korean government in that offshore funds have been marketed already via Korea institutional investors and have been managed by managers outside of Korea. Hence, they have little incentive to obtain the Korean adviser license and to have a commercial presence in Korea. Moreover, local Korean entities have little experience, expertise, and track records to attract Korean investors at an initial stage. See. Eun Jip Kim, "Rethinking Hedge Fund Regulation: Focusing on the U.S., the U.K., and Korea" Indian University School of Law-Bloomington, Page 164.

[227] Heejin Noh, "Strategies to develop Korea's hedge fund regulations"

[228] Bae, Kim & Lee LLC., " Proposed rule changes to spur Korea hedge funds" [online] available from http://www.legal500.com/c/south-korea/developments/26434

One trillion won or more in equity capital is required for securities firms, while 500 billion won or more in assets under management are required for an investment adviser and 10 trillion won or more is required for asset management companies.[229]

Also, there are more flexible qualifications for foreign hedge fund advisers, which means less stringent assets under management, track record, and investment management expert requirements. For example, 1 billion dollars (about 1 trillion won) in assets under management is required for a foreign manager to apply for a license in South Korea, while 10 trillion won in assets under management is required for Korean licensed managers.

3.4.3 Reporting and record keeping requirements

Under the Korean regime, every fund manager who acquires a license is subjected to the reporting requirement. They have to report their fund information such as financial statements and management reports. These requirements are the same requirement in the U.S. and the U.K. for the purpose of monitoring risky activities and mitigating potential systematic risk.[230] Also, both hedge fund managers and mutual fund managers have an obligation to deliver those reports to both investors and regulators, at least once every three months, according to FSCMA Article 88. Moreover, FSCMA Section 60 requires both hedge fund managers and mutual fund managers to keep and maintain records of data related to the operation of the financial investment business.

Also, a hedge fund manager is also subject to reporting requirements related to leveraged transactions such as money borrowing and over-the-counter derivatives transaction, main management strategy, and type of investment assets.[231]

As a result, both hedge fund managers and mutual fund managers under the Korean regime are required to file a report at least once every three months, which leads to the same frequency of reporting. These requirements are the same as the U.S. regime,

[229] Ibid.

[230] Ibid.

[231] The Financial Investment Services and Capital Market Act, Article 249-2(7).

which monitor risk activities and mitigate potential systemic risk. Under the Korean regime, however, there is no clear provision stating that the prevention of systemic risk is one of the goals of securities regulation.[232]

This periodic reporting requirement is equally applicable to both institutional investors and high net-worth individuals to ensure treatment of information access among the qualified investors in the fund.

3.4.4 Marketing the Fund

Under the FSCMA, no one is allowed to market a fund to investors without obtaining the relevant license, which means that any offer or sale of fund units is forbidden.[233] Also, the fund under the FSCMA must be sold through the local distributor or brokerage. Moreover, the local distributor or brokerage must be an institution licensed in Korea to engage in the investment dealing business or in the investment brokerage business, according to FSCMA Article 51. Once registered as publicly-placed funds, both hedge fund managers and mutual fund managers can sell their fund publicly to investors in Korea.

However, there are exemptions if the offer or sale was done on a private placement basis. If there was no public solicitation or advertisement, then they are allowed to market to certain qualified purchasers.[234]

As a result, even hedge fund managers can market funds directly to their investors, but they are still subject to fund distribution licensing requirements. Every

[232] Unlike the U.S. regime, the Korean regime tackles the systemic risk issue directly by providing an upper limit for leveraged transactions such as borrowing and speculative derivatives transaction, Moreover, to the reporting requirement, the Korean regime may be concerned with potential systemic risk, although there is no express provision under the FSCMA asserting that preventing systemic risk is a gold. Nonetheless, the licensing requirements applicable to hedge fund managers could be evaluated as being systemic risk focused because certain level of capital and appropriate internal control system should be in place to obtain license. See. Eun Jip Kim, “Rethinking Hedge Fund Regulation: Focusing on the U.S., the U.K., and Korea” Indian University School of Law-Bloomington, Page 183.

[233] See FSCMA, Art. 7,12

[234] See FSCMA, art. 9(7),(8),(19),249-2

fund in Korea must be sold through a local distributor or brokerage, which is an institution licensed in Korea. Such local distributors can engage in the "investment dealing business" according to FSCMA Article 51(1). The purpose of the fund distribution license requirement is that the government would like to ensure that high-net-worth individuals are sufficiently protected by the suitability rule when the fund manager markets them. On the other hand, the private fund manager can distribute a fund to investors directly, without a fund distribution license. As such, the private fund manager can sell the units directly to high net-worth individuals.

3.4.5 Investor qualifications

There is no qualification for mutual fund investors. Korean mutual funds are available for all type of investors. Also, a mutual fund manager has no obligation to comply with the suitability rules to verify an investor's status.

On the other hand, a hedge fund is a risky investment vehicle, so it is necessary to scope the type of investor who can access a hedge fund, meaning only certain high net-worth investors can invest in a hedge fund. Korean regulations (i.e. FSCMA) group investors by the amount of wealth they have, which is high net-worth investor (i.e. professional investors) and qualified investor. Being a high-net-worth investor means they must have assets for investment of at least 5 billion won to qualify. On the other hand, the amount of investment for a qualified investor is only 0.5 billion won.[235] Nonetheless, high-net-worth investors under the hedge fund regime are deemed to be nonprofessional investors under the FSCMA because the general professional investor threshold for the high-net-worth individuals is much higher than that for a hedge fund.[236]

The reason for the division of type of investors is that the regulator wants to treat them differently. For example, professional investors (i.e. institutional investors) who are deemed so under the Korea securities regulation do not need to take a sophistication test, and they can also invest directly in the fund. By contrast, non-

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[235] See FSCMA, art. 9(5)

[236] See FSCMA, art. 9(5), 249-2(1), 269(6).

professional investors (i.e. qualified investors) have to take a sophistication test before making an investment, even after they are deemed a qualified investor.[237]

Under the FSCMA, the suitability rules apply to non-professional investors only. Normally, qualified investors such as the suitability rule do not protect institutional investors. As mentioned before certain high-net-worth investors are deemed to be non-professional investors.[238] This unique phenomenon under the Korean hedge fund rule occurs because the Korean government takes the policy position that high-net-worth individuals should be under the regulatory protection of the suitability rule, while classifying them as qualified purchasers under the qualified investor's scheme. This regulatory approach may be understood as a somewhat inevitable one in Korea because the hedge fund market has just emerged. It most likely expects that it is hard to raise capital from institutional investors in the beginning because Korean hedge fund managers lack a track record or reputation for hedge fund management. Accordingly, high net-worth individuals are the primary targets for fund raising at the initial stage.

3.5 Hedge Fund proposal in Thailand

Currently, a mutual fund under Thai law has many investment restrictions that affect the choices for investment. However, there should be investment liberalization in the near future which allows Thai investors to make direct investment in the foreign market. On the other hand, there are still many investment restrictions for a local mutual fund, which may lead to disparity in competitiveness. As a result, the Thai SEC has seen an opportunity to preserve competitive advantage in the market. Thus, the Thai SEC will ease some of the investment restrictions, which will allow the fund to invest flexibly.

Thai SEC is currently in the process of hearing arguments to ease some of the investment restrictions. Under the new proposal, it allows the fund to make an investment without restriction. The fund might be regulated similarly to a mutual fund.

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[237] See FSCMA, art. 46.
[238] Ibid.

Meanwhile, the fund will only be available for a specific type of investor, such as institutional investors and Ultra-High net worth investors, due to its risk and complexity. Comparing the new rules with foreign regulation, it seems that the fund has some similarities and differences with a foreign hedge fund in terms of each investor needing to be a wealthy or institutional investor. Meanwhile, there is no exemption available compared to a foreign country. If the fund has assets under management of less than a specific amount, it is not required to register. In conclusion, a fund under the new proposal might be subject to the mutual fund regulation, but it has more investment ability than a mutual fund. It is available for a specific type of investor only.[239]

Nevertheless, the entity of a hedge fund in Thailand is different from foreign countries. For instance, a hedge fund in the U.S. and the U.K. is established as a private fund. More precisely, the hedge fund can be established as a limited company or limited partnership. On the other hand, a hedge fund in Thailand will be established as a mutual fund managed by an asset management company. Nevertheless, it is not prohibited from establishment as a hedge fund or a limited company, but there are several obstacles to raising capital and management. However, many countries including Thailand regulate hedge funds in the same way in terms of supervision. More precisely, a hedge fund and hedge fund manager is regulated similarly to a mutual fund, meaning some of the mutual fund's regulation might apply to a hedge fund and hedge fund manager. However, some of the mutual fund regulations might not apply to a hedge fund due to the risk and complexity of hedge fund investment. For instance, it has set the qualifications for a hedge fund according to the new proposal. Thus, the fund might be available for an Ultra high net worth investor or institutional investor.[240] Moreover, the mutual fund solicitation method cannot apply to a hedge fund because there are

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[239] The Publications of the Thai Securities and Exchange Commission, "The easing investment restrictions of the mutual fund that offered to non-retail investor" (อกน.19/2558)

[240] The Draft declaration of the Thai SEC, "Qualifications and definition of Ultra high net worth (UHNW) and the easing investment restrictions of the mutual fund that offered to non-retail investor" (อกน.3/2559)

additional processes that both hedge fund investors and sales persons might be required to take, such as a suitability test, know your client analysis, stress test, etc. In addition, a hedge fund cannot make a public solicitation according to the new rules. [241]

3.5.1 Disclosure requirements

According to the new proposal, the fund might be regulated similarly to the mutual fund. All material information must be provided in the prospectus and delivered to each investor. Furthermore, the Thai SEC emphasizes the disclosure to ensure that each investor receives necessary information before making a decision, as follows:

(1) For the disclosure on investment policy, the fund has to disclose details about the investment method and strategy.
(2) A prospectus must clearly specify that the fund is only available for institutional investors and Ultra-high net worth investors. It must also specify that this fund has investment restrictions as well as warn of the risk that might occur.
(3) The worst case scenario analysis as well as maximum loss, also specify the actual maximum loss from the previous year.
(4) The disclosure on risk management system, as well as specify the risk spectrum higher than Level 8 in the prospectus. The fund has to expose its actual investment. Moreover, the annual report must explain in detail about returns from the investment from the previous year.[242]

The Thai SEC requires a hedge fund to disclose more specific types of information regarding its risk than a mutual fund. According to the risk and complexity of a hedge fund investment, each investor should be better warned regarding the risk than a mutual fund investor. As a result apart from ordinary disclosure, a hedge fund is required to

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[241]The Declaration of the Thai SEC, “Guidelines, condition and management of non-retail investor fund.” Article 8, (ทน. 17/2556)

[242] The Publications of the Thai Securities and Exchange Commission, “The easing investment restrictions of the mutual fund that offered to non-retail investor” (อกน.19/2558)

disclose additional information regarding the risk and awareness of a hedge fund investment.

3.5.2 Reporting requirements

Thai SEC foresees the potential risks that may arise from the operation of a hedge fund in Thailand. Having better tools to deter and detect unlawful activities from a hedge fund business means the reporting requirement is necessary to monitor the hedge fund business in Thailand. According to the new proposal, the fund might have an obligation similar to a mutual fund, which is required to file a report to the authorities.[243]The Thai SEC would require the fund to report material information regarding the fund operation and trading practice. Nevertheless, there is similarity and difference compared to other countries. First, the Thai SEC requires a hedge fund to report information regarding the fund operation and systemic risk concern such as the value at risk, back test result, stress test result, assets holding, and investment result. On the other hand, there is only one classification for reporting requirement under the new regime. Compare this to foreign countries like the U.S., which classify hedge funds into three classes including small fund, middle fund, and large fund. Each of the funds has different obligations for reporting. The bigger fund is required to report more frequently than the smaller one. However, the Thai SEC requires a hedge fund to report such information monthly basis, regardless of the fund's size.[244]

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3.5.3 Marketing the Fund

According to the new proposal, some of the mutual fund regulations may apply to a hedge fund. However, some of the regulations cannot apply, such as for advertisement, solicitation, sales process, and initial investment. The mutual fund has a less regulatory obligation in the offering process. On the other hand, the fund manager has to solicit investor carefully to ensure that each investor understands the risk and complexity of hedge fund investment due to the risk and complexity of hedge fund

[243] The Publications of the Thai Securities and Exchange Commission, "The easing investment restrictions of the mutual fund that offered to non-retail investor" (อกน.19/2558)

[244] Ibid.

investment. Thus, there are additional rules for a hedge fund on offering the fund to ensure that each investor understands the risk and complexity of hedge fund investment. First, the offering might be made by a designated sales person. The sales person must understand and be able to explain in detail regarding the fund to the investor. Second, there are some processes that the investor and sales person have to undertake, such as a know your client analysis, suitability test, financial objective, investment horizon, and risk tolerance level. The results from these tests are necessary to assess whether or not the investor is suited for the fund. Third, the sales person must provide a prospectus and deliver it to the investor. Moreover, the sales person must explain in detail about the risks regarding the maximum potential loss in a worst case scenario. Lastly, the sales person must provide an independent party to review the investor's understanding.

As a result, it seems a hedge fund has a more regulatory obligation during offering process compared to a mutual fund under the new proposal. A hedge fund has to go through several processes such as a suitability test, know your client analysis, financial objective, investment horizon, risk tolerance level, as well as warning the risk of investment. Moreover, the public offering is prohibited as well as online solicitation because a hedge fund investment is hard to understand. Thus, it is necessary for an investor to be given an explanation about an investment. [245]

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3.5.4 Investor qualifications

As mentioned earlier that investing in a hedge fund requires sufficient wealth and knowledge because the hedge fund is a risky and complex investment vehicle, only specific types of investors can invest in a hedge fund. Previously, the Thai SEC set the qualifications for high net worth investors according to their level of wealth. However, such qualifications might not be enough for a hedge fund investor due to the risk of hedge fund investment. Thus, the hedge fund investor qualifications would be an ultra-

[245] The Securities and Exchange Commission, "Hearing: an improvement of the rules one offering process", (อกน.18/2559)

high net worth investor, which is higher than a high net worth investor, to ensure that the hedge fund investor could bear the economic risk.

According to the new publication from the Thai SEC, the qualifications for a hedge fund investor can be divided into two types, including an institutional investor and ultra-high net worth investor. According to the publication, the definition of institutional investor can include and be defined by banks, securities companies, insurance companies, mutual funds, private funds, investment companies, and any other institution with similarity. On the other hand, an individual investor who is willing to invest in a hedge fund must qualify in one of the following qualifications. First, he or she with their spouse must have a net worth of at least 70 million baht or have an income of at least 10 million baht or 7 million without a spouse. An investor may have an investment portfolio of at least 50 million baht. In comparison with a high net worth investor, it seems that the ultra-high net worth investor requires significantly more wealth. The ultra-high net worth investor requires roughly 70-100% more than a high net worth investor.[246]

[246] The Securities and Exchange Commission, “Hearing: the definition of ultra-high net worth investor and easing investment restriction on non-retail investor fund”, (อกน. 3/2559)

Chapter 4

Analysis of Hedge Fund Manager Regulations in Thailand

4.1 Current regulatory environment

Basically, a hedge fund manager and mutual fund manager have similarities in terms of their roles and responsibilities. Also, both are pooled investment vehicles.

In countries where hedge fund markets have not been well-developed in the past or were not naturally formed by demand and supply, such as Germany and South Korea, the government prefers to regulate both hedge funds and their managers while implementing rules and regulations. These rules and regulations are more like those for mutual fund regulations in nature and substance because both hedge funds and mutual funds have similarities in terms of fund management and investors' protection issues. As a result, hedge fund regulations in those countries are similar to a mutual fund's regulations.[247]

As mentioned above that both a hedge fund and mutual fund have similarities in many ways, the regulator tends to regulate both hedge funds and hedge fund managers like a mutual fund and mutual fund manager. The hedge fund has played a constructive role in part because it remains lightly regulated or unregulated. It is a special investment vehicle for sophisticated investors, so it is unnecessary to tightly regulate it because hedge fund investors are a sophisticated group. Moreover, hedge funds in some countries may not be subject to some of the regulations designed to protect investors, depending on the amount of assets under management of hedge fund manager. Furthermore, some hedge fund managers may not be required to register or file a public report with the authorities. As a result, hedge fund investors may not receive all of the regulatory protection that commonly applies to a mutual fund investor.

[247] Eun Jip Kim "Rethinking Hedge Fund Regulation", School of law Bloomington University. May 2014.

Nevertheless, the Thai SEC is currently in the process of hearing arguments to ease some of the investment restrictions, which would allow establishing a hedge fund in Thailand. According to the hearing, the new rules would allow a fund to make investments without any restrictions. The fund might be subject to regulation similar to a mutual fund's regulation. Nevertheless, The fund has some similarities and differences compared to a foreign hedge fund in terms of each investor being a high net worth investor or institutional investor. In conclusion, the fund might be subject to the mutual fund regulation according to the hearing. However, the fund has no investment restrictions and would be available for a specific type of investor.[248]

Compared to foreign countries, the entity of a hedge fund in Thailand is different. For instance, a hedge fund in the U.S. and the U.K. is established as a private fund. More precisely, a hedge fund can be established as a limited company or limited partnership. On the other hand, a hedge fund in Thailand will be established as a fund managed by an asset management company. In terms of supervision, many countries regulate hedge funds in the same way. More precisely, the hedge fund and hedge fund manager's regulations are similar to a mutual fund manager's regulations. However, there might be some additional regulations which apply to a hedge fund and hedge fund manager due to the risk and complexity of hedge fund investment. For instance, the qualifications for a hedge fund investor in Thailand restrict only ultra-high net worth investors for investment in a hedge fund.[249] Moreover, each investor must do a suitability test before making an investment in a hedge fund. [250]

Nonetheless, as mention earlier that a hedge fund is a flexible investment vehicle which can be established in any form, there is no any regulation in Thailand

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[248] The Publications of the Thai Securities and Exchange Commission, "The easing investment restrictions of the mutual fund that offered to non-retail investor" (อกน.19/2558)

[249] The Draft declaration of the Thai SEC, "Qualifications and definition of Ultra high net worth (UHNW) and the easing investment restrictions of the mutual fund that offered to non-retail investor" (อกน.3/2559)

[250]The Declaration of the Thai SEC, "Guidelines, condition and management of non-retail investor fund." Article 8, (ทน. 17/2556)

which prohibits a hedge fund from establishment in the form of a limited company. Thus, a hedge fund can be established in limited company form. However, a hedge fund that forms as a limited company in Thailand is not within the SEC's oversight, but rather is regulated by the Ministry of Commerce due to the type of business. Furthermore, a hedge fund which forms as a limited company is not subject to the securities regulations of Thailand, which means there is no securities regulation to supervise the hedge fund business in Thailand if they form as a limited company. Nevertheless, there are several obstacles for operating a hedge fund in a limited company form in Thailand. First, according to the Securities and Exchange Act Section 34 and Civil and Commercial Code of Thailand Section 1102, it prohibits a limited company from making a public solicitation. A hedge fund cannot publicly offer the fund to investors. Second, according to Section 1222 of the Civil and Commercial Code of Thailand, it required all new shares to be offered to shareholders in proportion to the shares held by them. In other words, the new shares cannot be offered to the new investors. Thus, there might be obstacles for a hedge fund manager to raise additional funds or get more investors.

In addition, many countries tend to regulate hedge funds and hedge fund managers in the same way by subjecting them as investment advisers the same as a mutual fund manager due to the fact that both of them have similarities. Nonetheless, hedge fund managers might be subject to the same category as a mutual fund manager. However, there are still some differences due to the specialty of hedge fund manager and investment ability of a hedge fund. For instance, both hedge fund managers and mutual fund managers in the U.S. are classed as investment advisers required to register before performing their duties. Also, both of them are required to disclose and report information to their investors and the authorities. As illustrated, both hedge fund managers and mutual fund managers tend to be regulated similarly. However, there are some exemptions available for a hedge fund manager that allows them to be free from regulatory requirements such as registration, disclosure, and reporting. Nevertheless, these exemptions mostly depend on the assets under their management. If a hedge fund manager has assets under management less than a certain amount, such a hedge fund manager is free from those regulatory requirements.

The level of regulatory oversight between a hedge fund manager and mutual fund manager is different. Basically, a mutual fund regulation tends to focus on disclosure and transparency to protect the public interest. On the other hand, a hedge fund regulation tends to focus on systemic risk and other financial problems. As a result, they are not regulated the same. However, in term of investor protection, both hedge fund managers and mutual fund managers are subject to the same regulations, which are designed to prevent any unlawful activities against an investor.

Thailand has the same mutual fund regulatory structure as other countries. For instance, a mutual fund manager requires registration, disclosure requirement, marketing, and anti-fraud provision. Hence, Thailand can treat hedge fund managers as one of the fund managers and apply some of the mutual fund manager regulations to them. Nevertheless, a hedge fund business and mutual fund business are different. As such, it is necessary to balance hedge fund regulation in order to preserve competitive advantage and regulatory oversight. Moreover, the Thai SEC already has tools and methods with which to monitor the risks posed by a fund. Thus, it would be reasonable to adopt some of those mutual fund regulations to hedge fund regulation.

To promote the hedge fund business in Thailand, regulators can adopt some of the mutual fund and mutual fund manager regulations to a hedge fund and a hedge fund manager. However, some of the regulations and processes must be adapted before being applied to a hedge fund.

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4.2 Qualifications of fund managers

Despite the various conflicting opinions and arguments raised thus far, it is obvious that more stringent regulation of hedge funds is necessary after the global financial crisis in 2008. Despite the hedge fund regulation framework varying from country to country, this regulatory reform has been justified mainly from a macro-prudential or systemic risk regulatory perspective. Nevertheless, the issue is how to regulate a hedge fund and to what extent they should be regulated. Regulating hedge fund managers is predicated on the belief that it would be better to leave a hedge fund unregulated, considering the overall market benefits they create and derive from the fact that they have been unregulated. It is also premised on the grounds that their negative impact on

the market could be controlled and managed by regulating hedge fund managers rather than the funds themselves because the manager is the very person that has unlimited discretion in investing and managing the fund's assets. Imposing mandatory registration or licensing obligations, together with periodic reporting, recordkeeping, and examination requirements are efficient ways to supervise the hedge fund business.

This regulatory model has been adopted by many countries such as the U.S., the U.K., and South Korea. By regulating the hedge fund manager, the potentially negative impact that the funds may pose to the market and investors is minimized.[251]

In some countries like the U.S., there is no qualification to be a fund manager, whether a hedge fund manager or mutual fund manager. Thus, anyone can be a fund manager by filing an application form and registering as one. On the other hand, there are qualifications for being a fund manager in many countries such as an education background or experience. In South Korea, the fund manager must have at least two years of experience in securities investment and complete training provided by the Korea Financial Investment Association.

In Thailand, there are qualifications for being a fund manager. There are three ways to nominate a fund manager to qualify as a fund manager, which includes completing the course license or being the management officer of a company.

First, the course that such a fund manager must complete consists of the following:

- Complete a test about securities regulation, Standards of Practice and Code of Ethics and others related regulations provided by the securities commission.[252]

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[251] Eun Jip Kim, "Rethinking Hedge Fund Regulation: Focusing on the U.S., the U.K., and Korea", Indiana University School of Law, Chapter III Part B 3.

[252] "The Declaration of The Securities and Exchange Commission on "The definition of institutional investor and high net-worth investor", The Securities and Exchange Commission, Kor Jor (กจ)9/2555), article 7 (1).

Second, the license that such fund manager has to obtain consists of the following:

- Chartered Financial Analyst (CFA) Level 1, or Certified Investment and Securities Analyst (CISA) Level 1 with 2-year work experience in the securities market.
- Chartered Financial Analyst (CFA) Level 3, or Certified Investment and Securities Analyst (CISA) Level 3.
- Or authorized by the securities commission in such person's domicile.[253]

Third, such a person who is qualified by using their position as a management officer in such a company or any other position having the highest responsibility in securities market field and take a full course related to securities regulation Standards of Practice and Code of Ethics.[254]

In conclusion, each country has a different approach to qualifying their fund managers to ensure that such persons are suitable and will manage investors' money in their best interest. Also, Thailand seems to set a higher qualifications standard than some other countries because Thailand requires both an education background and experience, as stated above.

4.3 Hedge fund manager registration

In principle, there is no substantial difference in the hedge fund manager regulatory framework because the hedge fund regime has been regulated similarly with other fund managers to oversee fund manager's activities after the global financial crisis of 2008.

Under the three countries regime, hedge fund management has come under direct regulatory oversight. In the past, hedge funds and their managers were

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[253] "The Declaration of The Securities and Exchange Commission on "The definition of institutional investor and high net-worth investor", The Securities and Exchange Commission, Kor Jor (กจ) 9/2555),article 7 (2).

[254] Ibid, article 8.

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unregulated or lightly regulated in the U.S. and U.K. That was until the global financial crisis, which resulted in the regulatory reform in recent years. The financial crisis caused regulation of hedge funds and hedge fund managers more tightly. As a consequence, the U.S. and U.K. regulators made the decision to regulate hedge funds and their managers more tightly by requiring them to register with the authorities and file more specific information. The Korean regime also took the same approach as the U.S. and the U.K. The regulators would like to ensure that hedge fund managers are within their oversight to prevent potential impact on the financial market.

Normally, a hedge fund has some similarities to a mutual fund. For instance, both hedge funds and mutual funds are pooled investment vehicles that invest in the financial market through equities, bonds, options, and some other assets, which are run by a fund manager. However, there are differences. First, the range of investment strategies available to hedge funds and the type of positions they can take are quite broad and complex. Nevertheless, both fund managers have similarities in terms of management and duties. As a result, the regulators in many countries tend to regulate hedge fund managers and mutual fund managers similarly.

As illustrated in Chapter 3, the U.S. regime has regulated hedge fund managers as a fund adviser under the Investment Adviser Act, which is the same as the mutual fund manager, both of them are required to register with the authorities before operating securities business. Under the U.K. regime, hedge fund activity is considered regulated activity, which needs to be authorized first, whether or not they are required to obtain an authorization under the AIFMD. Under the Korean regime, Korea hedge fund managers are subject to authorization requirements through licensing requirements. In conclusion, hedge fund managers in each country take a different approach to become fund managers. However, the process and purpose are similar; each has to be authorized or registered. As such, the authorities can oversee hedge funds and hedge fund managers to be able to provide financial protection to both investors and the financial market.

In some countries such as the U.S. and the U.K., a hedge fund can be established in the form of a limited company or limited partnership, having investors as

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shareholders. Thus, the scope of supervision does not cover a certain type of fund, but rather considers the essence of the fund. Generally speaking, the entity is subject under the authority's oversight and considered by its business that collects money from investors to generate a return on investment. Such an entity must be subject to oversight by the authorities.

As illustrated before, a mutual fund has some similarities in nature of business with a hedge fund collecting money from investors and generating a return for that money. However, a hedge fund cannot be established as a mutual fund or private fund due to some investment restrictions. Mutual funds are restricted to making investment only to certain types of assets such as equity and required to preserve investment ratio and leverage limitation.[255] As a result, even a mutual fund has some similarities in nature of business with a hedge fund, but considers the fact that they are different in terms of investment policy and investor qualifications.

According to some research, the idea that a hedge fund should be subject to the SEC's oversight is realized by subjecting them as securities businesses. Moreover, a hedge fund manager might be regulated similar to a mutual fund manager or apply some part of a mutual fund manager's regulations to a hedge fund manager. However, some regulations may not apply to a hedge fund manager due to the differences. Thus, the authorities may impose additional rules. The Thai SEC already used this approach. For instance, mutual funds are subject to the general regulation. However, in some cases such as for REIT, a private fund, or gold fund, additional rules aside from general rules are subject.[256]

From the point of view of the author, the most efficient way to regulate a hedge fund business is to regulate the hedge fund manager. It is premised on the grounds that the negative impact of a hedge fund to the market could be controlled and managed by regulating the hedge fund manager rather than the fund itself because the hedge fund

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[255] The Declaration of the Securities and Exchange Commission on "Investment and exist fund's assets" (Sor nor 24/2552).

[256] Yuwadee Amornsirivipa, Chulalongkorn University, Master of Law program in Finance and Tax Laws Faculty of Law, Chapter 6, 6.2

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manager is the person who has unlimited descretion in investing and managing and also take responsibilities of the fund assets on a continuous basis.[257]

As mentioned above that Thailand also has some licensing requirement which requires every fund manager to obtain such license before operating their business, it is more efficient and reasonable for Thailand to take the same approach with other countries by requiring hedge fund managers to take the registration process like other fund managers. According to "the Declaration of The Securities and Exchange Commission on the Nomination and Duty of Fund Managers B.E. 2552", both mutual fund managers and private fund managers are required to obtain a license and be authorized by the authorities first before becoming a fund manager.[258]

Under the Thailand regime, every fund manager whether mutual fund managers or private fund managers are required to register with the SEC. However, there is no category for a hedge fund manager license. To solve this problem, a hedge fund manager should be subjected to the same category like a mutual fund manager. In many countries like the U.S., the U.K., and Korea, this regulatory model categorizes a hedge fund manager as an investment adviser the same as a mutual fund manager. In the U.S., which subjects hedge fund managers and mutual fund managers as investment advisers, they are required to take the same registration process. Under this approach, even a hedge fund manager is categorized as an investment adviser like a mutual fund manager, but they are regulated differently. These regulatory obligations may be relatively lighter in some areas than those applied to mutual fund managers. However, the Thai regulator has the authority to enact additional regulations for hedge fund management in the future. The SEC had already used this method in other funds. For instance, the general regulation will apply to a mutual fund manager and the specific or additional regulation will apply to the fund manager who has a specific purpose such

[257] Michael Madonal, Notes and Comments, "Containing Systemic Risks: New Developments in Trans-Atlantic Hedge Fund Regulation, 34 LOY.L.A. INT'L & COMP. L. REV. 237, 241.

[258] The Declaration of The Securities and Exchange Commission on "The definition of institutional investor and high net-worth investor", The Securities and Exchange Commission, Kor Jor (กจ)9/2555), article 7.

as REIT fund, pension fund, and gold fund.[259] Hence, any issue about hedge fund management may be converged in this direction eventually. Because regulatory efforts should be made to treat them more like mutual fund managers, both of them have similarities in nature and substance. Meanwhile, there are little differences between them based on the regulatory concerns exist in both industries.

Nevertheless, the Thai SEC is currently in the process of hearing arguments to ease the investment restrictions on mutual funds. The new investment flexibility would allow the mutual fund to make investments without any restrictions. Under the new rules, the fund would be regulated similarly to a mutual fund. The fund has some similarities and differences with a foreign hedge fund in terms of each investor being a high net worth investor or institutional investor.[260]

Requiring a hedge fund manager to register would give the authorities the size and assets under management of the hedge fund industry in Thailand. It is a necessary tool to assess the systemic risk with the increase in the size of hedge fund and their role in the financial market, it becomes crucial to keeping an eye on their assets size, portfolio, and leveraged positions on an ongoing basis. By doing so, the SEC can take appropriate measures to prevent or mitigate any potential market disruption promptly. Moreover, registration would provide several benefits, such as increase disclosure standards to create a more efficient market and also ensure that hedge fund managers comply with fiduciary duties. It will enable the SEC to protect financial market stability.

4.4 Disclosure requirements

Transparency is the most important thing in fund management because it is one of the investment risks that need to be taken into account. Normally, a hedge fund manager will disclose information only to the point where the benefits equal the costs. The benefits of disclosure are that the fund can attract more investors, obtain terms

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[259] Yuwadee Amornsirivipa, “Legal Measures on Encouraging and Regulating Hedge Funds” Master of Law program in Finance and Tax Laws, Chulalongkorn University.

[260] The Publications of the Thai Securities and Exchange Commission, “The easing investment restrictions of the mutual fund that offered to non-retail investor” (อกน.19/2558)

more favorable to the fund (i.e. higher fees), and raise capital and enter into trades with counterparties at a lower cost. The lack of transparency could affect the investor's decisions. There is no doubt that certain types of information should be provided to investors before they make an investment, so it is very common to provide a certain disclosure document to meet the investors' due diligence requests.

Also, there are three types of information that each investor takes into account before investing in a hedge fund, including the hedge fund manager personal information, past fund performance, and the offer information.

Under the U.S. regime, a hedge fund manager and mutual fund manager registered as investment advisers were required to provide a prospectus before offering their fund to the public. Also, they are required to disclose all material information via the ADV form during the registration process. A fund manager also has duties to disclose accurate and complete fund accounts and balance sheets. The ADV form consists of a series of questions such as background information, related personal information, manager's business, additional compensation, and asset holding. Furthermore, a hedge fund manager also has to comply with the securities laws by providing necessary information during the offering process, as well as disclosing the fund's information to the authorities if they do public marketing. As a result, a hedge fund manager has duties to disclose all material information about himself and the fund. Such information must be accurate, correct, and not misleading.

Under the U.K. regime, hedge fund managers have duties to provide all material information before engaging with investors. [261]The information that a U.K. hedge fund manager has to provide for investors includes fund strategies, the objective of the fund, liquidity risk, fees, annual report, historical fund performance, latest net asset value. Moreover, a hedge fund manager has to inform each investor of any change in information without delay.

The disclosure between a hedge fund and mutual fund is different. As mentioned before that in U.S. there are exemptions for a hedge fund to rely on. Hence, such

[261] The Alternative Investment Fund Managers Regulation 2013, article 24.

disclosure requirements between a hedge fund and mutual fund are unlikely to provide the same level of transparency. For instance, a mutual fund is required to disclose their fund's information in prospectus form. By contrast, a hedge fund which may rely on an exemption from registration is not required to provide a prospectus to investor. In practice, a hedge fund manager usually provides a memorandum to investors. Basically, a hedge fund manager can choose whichever information that he will deliver to the investor via memorandum. Compare this to the mutual fund disclosure requirement, where there is no disclosure requirement for an exempted hedge fund. On the other hand, if such a hedge fund is subject to registration, that hedge fund is required to comply with the mutual fund disclosure requirement. Moreover, a hedge fund may require disclosure of additional information to both the public and investors regarding the risk and complexity.

In Thailand, there is a possibility that a hedge fund can be established regarding the hearing of the Thai SEC. Under the new rules, a hedge fund would be regulated similarly to a mutual fund. Thus, the mutual fund disclosure requirement might apply to a hedge fund.[262]

A mutual fund is required to provide a prospectus to each investor. The prospectus contains the necessary information for the investor to make a decision in investment. Such information may include biographies of officers and directors, financial statements, a description of the company's business, detailed information about their compensation, and any other material information.

A hedge fund might be subject to mutual fund regulation, but a hedge fund and mutual fund are different in terms of investment purpose and investment restriction. Basically, a hedge fund is a risky and complex investment vehicle compared to the mutual fund. It is also very hard to understand and assess the risk from investment.

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[262] The publication of the Thai Securities and Exchange Commission, "guidelines, condition and management of non-retail investor fund" (ทน.17/2556)

Hence, it is necessary to provide the investor with sufficient information to ensure that the investor can assess and realize the risk.

Regarding the hedge fund proposal of the Thai SEC, a hedge fund would be required to disclose additional information apart from the mutual fund disclosure. The additional information includes the following information:

(1) The disclosure on investment policy, the fund has to disclose details about the investment method and strategy.
(2) Such a prospectus must clearly specify that the fund is only available for institutional investors and ultra high net worth investors. It must also specify that this fund has investment restrictions as well as warn about the risks that might occur.
(3) Worst case scenario analysis as well as maximum loss, also specify the actual maximum loss from the previous year.
(4) The disclosure on risk management system, as well as specify the risk spectrum higher than Level 8 in the prospectus. The fund has to expose their actual investment. Moreover, the annual report must analyze and explain in detail about the return from the investment from the previous year.[263]

In conclusion, there is some additional information which a hedge fund manager has to disclose apart from an ordinary disclosure.

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From the point of view of this author, a hedge fund manager should be subject to the disclosure requirement like a mutual fund manager by requiring them to provide a prospectus to investors.[264] According to the nature of hedge fund investment, however, the hedge fund disclosure standard should be higher than the mutual fund disclosure standard due to the risk and complexity of hedge fund investment. To ensure

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[263] The Publications of the Thai Securities and Exchange Commission, "The easing investment restrictions of the mutual fund that offered to non-retail investor" (อกน.19/2558)

[264] Regulation of the stock exchange of Thailand, "Re: Disclosure of information and other Acts of a Mutual fund".

that each investor understands and is informed regarding the risk of investment, additional disclosure is necessary.

4.5 Reporting and Record-keeping Requirements

Normally, hedge fund managers and mutual fund managers are regulated similarly except that hedge fund managers are subject to additional regulatory requirements. Nevertheless, both of them are required to report and maintain information for a certain period. However, the frequency and type of information depends on the kind of the fund and its size. Hence, both hedge fund manager and mutual fund manager are required to file a report with the SEC, but there are differences in the type of information for reporting. Since hedge funds always carry substantial risk and manage large assets, this requirement will allow the authorities to conduct and analyze the systemic risk posed by hedge funds and can hold hedge fund managers to more stringent reporting and record-keeping requirements. The title requires hedge fund managers to provide and maintain records regarding the fund's activities.[265] These records must include information necessary to the public interest, for the protection of investors, or for the assessment of the systemic risk of the fund. The records must consist of information on assets under management, use of leverage, counterparty credit risk exposure, trading and investment positions, valuation policies and practices, type of assets, side arrangement or side letter, and trading practices, and other information deemed necessary by the SEC.[266] Additionally, all records of a hedge fund maintained by a hedge fund manager are subject to periodic, and special examination is the SEC to protect the public interest and for the protection of investors or the assessment of systemic risk. Moreover, this information can be shared among authorities. However, the authorities have a strict requirement to keep this information confidential.[267]As a result, this requirement would create a source of data for the authorities to use in assessing systematic risk, examination, investigation, and investor protection effort relating to hedge fund manager.

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[265] See. 15 U.S.C. § 80b-4
[266] Ibid.
[267] Ibid.

As mentioned, the reporting and the record-keeping requirement is based on systemic risk concerns because systemic risk can cause market failure and financial crisis. The potential for systemic risk exists not because of its intrinsic status as a hedge fund, but rather by the sheer size of its exposure to other institutions and market participants. In identifying regulatory approaches, the regulator takes into account the goals of stability and efficiency as well as the costs of regulation based on these objectives. As a result, the regulator divides hedge fund managers into three categories to balance regulatory obligation and effectiveness, which are small fund adviser, mid-size adviser, and large fund adviser. Each of them has a different regulatory obligation in terms of the type of information reporting and the frequency of reporting. The small fund adviser has a less regulatory obligation on reporting than other bigger fund advisers. The regulator believes that a small hedge fund does not pose the same risk as a large hedge fund. Also, their activities are not interconnected with the global financial system. Moreover, such loss does not ripple throughout world markets, but borne by fund investors alone even with the risk posed by them.[268]

The purpose of reporting requirements was to oversee the financial market and prevent the systemic risk caused by financial businesses. Hence, supervising those financial businesses, especially hedge funds, is necessary to require a particular type of information from the financial business. According to its investment ability and complexity, the hedge fund can invest in many kinds of an asset via various investment tool. Some said most of the time hedge fund caused the systemic risk, because when large hedge fund use leverage but subsequently run out of cash and thus cannot meet its obligations, either because of a negative net asset value or temporary lack of liquidity. Thus, a particular type of information must be reported to monitor such risk.

Under the Thai regime, it seems that Thai authorities are also concerned about the systemic risk posed by a hedge fund. Regarding the hearing of the Thai SEC, the Thai SEC also proposes reporting requirement rules. It requires a hedge fund to report the fund's information to the authorities monthly. Under the new rules, the reporting obligation between a hedge fund and a mutual fund would be similar since a hedge fund

[268] See. Senate Committee Report, S. REP. NO. 111-176, at 74,

would be required to comply with the mutual fund reporting requirements. However, there is an additional reporting requirement which tends to focus on systemic risk. Hence, a hedge fund is required to report additional information to the SEC; such information may include the value at risk, back test result, stress test result, assets holding, and investment result. This information is used to monitor the risk posed by a hedge fund.[269] [270]

Comparing to foreign countries, there are some similarity and difference. First, there is no classification on the size of a hedge fund. In foreign countries which classify hedge fund by its size whether the small fund, middle fund or large fund, also, each of the funds has difference regulatory obligation. In other words, the bigger fund has to report more frequent than the smaller one. On the other hand, under the new proposal of the Thai SEC, there is no classification, but every hedge fund in Thailand are required to report on monthly basis. Nonetheless, there is a similarity between the reporting requirement between Thailand and foreign countries. First, a hedge fund is required to comply with a mutual fund reporting requirement with an additional reporting requirement apart from a mutual fund reporting requirement. Such reporting requirement is focused on the systemic risk concern which requires a specific type of information to monitor the fund operation.

From the point of view of this author, the reporting requirement under the new proposal of hedge fund operation in Thailand is sufficient to monitor the fund operation as well as prevent the systemic risk that might occur.

[269] The Publications of the Thai Securities and Exchange Commission, “The easing investment restrictions of the mutual fund that offered to non-retail investor” (อกน.19/2558)

[270] The Publication of the Thai Securities and Exchange Commission of Thailand, “the disclosure of the mutual fund.” (บจ/ป 16-02)

4.6 Marketing the Fund

Because a hedge fund is a very risky investment vehicle and also lacks transparency, it is necessary to limit the number and type of investors who would get involved in the fund.

Generally, a fund is required to register before offering or selling to the public unless they meet an exemption. For example, under Regulation D, Rule 506 in the U.S. known as "safe harbor" for private offering exemption of the Securities Act Section 4(a), a fund cannot publicly solicit or advertise the interest or securities to the public. It also limits their sale of interest up to 35 non-accredited investors and an unlimited number of accredited investors. Once the offer or sale is not registered, a hedge fund manager can decide which information to give to accredited investors so long as it is not against the antifraud prohibition. On the other hand, a hedge fund manager must give disclosure documents the same as those used in registered offerings. However, a hedge fund manager can broadly solicit and advertise the offering if all the prospective investors are accredited.[271]

Under the Korean regime, the marketing or sale of the interest in investment funds to a resident of Korea is subject to regulation under the Financial Investment Services and Capital Markets Act (FSCMA). In Korea, there is no definition of general solicitation or advertisement, so any mass communication with public or groups of prospective investors are considered as general solicitation or advertisement, [272] but it must be made through a licensed South Korean financial investment company. In other words, every fund in Korea must be sold through a local distributor or brokerage, which is an institution licensed in South Korea and authorized to engage in the investment

[271] "Rule 506 of Regulation D" U.S. Securities and Exchange Commission, [online] available at: http://www.sec.gov/answers/rule506.htm

[272] The Financial Investment Services and Capital Market Act, Article 9 (7).

dealing business. Also, an interest in offshore funds must be marketed through a local sales agent licensed in South Korea.[273] [274]

It seems that the U.S., the U.K., and Korea regulate hedge fund marketing in the same way albeit with slight differences. The U.S. and the U.K. both widely define the meaning of marketing as, "any person whether directly or indirectly make use of any means or instruments of transportation or communication to sell or purpose to sell such securities."[275] However, there is a private placement exemption which allows a hedge fund manager to market their funds as long as it does not go against the safe harbor rules. By contrast, Korea has strictly regulated marketing activities, where every offer or sale must be made through a licensed financial investment company, whether the marketing is public or private.

As a result of the three countries regime, fund marketing is deemed securities or securities activity, which must be registered or done by a licensed institution before introducing their fund to the public.

However, there is an exemption that the fund manager can market their fund to investors through private placement, except in the Korean regime. Under this method, unregistered securities (i.e. fund units) can offer to a small number of chosen investors through private placement offering.

According to the proposal of hedge fund regulations in Thailand, there is a possibility that mutual fund regulation might apply to a hedge fund. However, even some of the mutual fund regulations may apply to a hedge fund. However, some of the regulations cannot apply, including an advertisement, solicitation, sale process, and initial investment. The mutual fund has less regulatory obligation on the offering process compared to new hedge fund proposal rules. On the other hand, the risk and

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[273] Addison Braendel, Annie Eunah lee, "Marketing Fund Interests: Focus on South Korea", [online] available from: http://ssrn.com/abstract=1859585

[274] Je Won Lee, Jung Hwan Lee & Geen Kim, Lee & Ko, "Investment funds in South Korea: regulatory overview", [online] from: http://uk.practicallaw.com/8-521-7359?source=relatedcontent#a747924

[275] See. 15 U.S.C. § 77e.

complexity of hedge fund investment means that under the new rules, the fund manager has to solicit investors carefully to ensure that each investor understands the risk and complexity of hedge fund investment. There are additional rules for a hedge fund on offering the fund to ensure that each investor understands the risk and complexity of hedge fund investment. First, the offering must be made by designated sales person, and the sales person must understand and be able to explain in detail regard the fund to the investor. Second, there are some processes that investor and sale person have to take such as know your client analysis, suitability test, financial objective, investment horizon, and risk tolerance level. The results from these tests are necessary to assess investors and whether or not they are suited for the fund. Third, the sales person must provide a prospectus and deliver it to the investor. Moreover, the sales person must explain in detail about the risks regarding the maximum potential loss in the worst case scenario. Lastly, the sales person must provide an independent party to review investor understanding.

Comparing to foreign regulations, it seems that Thailand has similarities in the way that the hedge fund is restricted to offering the fund to a specific type of investor. According to the declaration of the Thai SEC, the offer, marketing, or any sale method of the mutual fund may not apply to a hedge fund. Thus, a hedge fund cannot be offered to a retail investor.[276]

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As a result, the Thai SEC would regulate hedge fund marketing in the same direction with other countries, which prohibit hedge funds to offer to the retail investor. Moreover, the SEC wants to ensure that each investor is informed about the risk and complexity of hedge fund investment by requiring them to take several processes such as a suitability test, know your client analysis, financial objective, investment horizon, risk tolerance level, as well as warning the risk of investment. Hence, under the new proposal, a hedge fund may have an additional regulatory obligation to warn their investors regarding the risk and complexity. Moreover, the mutual fund's marketing rules may not apply to a hedge fund, but the hedge fund may have to comply with the

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[276] The Declaration of the Securities and Exchange Commission on, "Guidelines, term, establishment management and investment of non-retail fund", Article 8 (ทน. 17/2556)

new rules that specify the type of investor who can invest in a hedge fund. Thus, a hedge fund may be available only to a specific type of investor. A hedge fund investment is very hard to understand. As such, it is necessary that an investor is offered an explabnation about an investment. [277] When comparing hedge fund marketing processes and mutual fund marketing processes, it seems the hedge fund has more regulatory obligations to inform and provide information regarding the risk of investment to the investor.

4.7 Investor qualifications

The main purpose of the qualified investor concept is to identify the person willing to invest in a hedge fund to ensure that each of can bear the economic risk of hedge fund investment. They are divided by their wealth or financial experience. Also, a hedge fund manager has a duty to screen each person before accepting their investment.

As mentioned before, the U.S., the U.K. and Korea have set a qualifications for people who can invest in a hedge fund. Furthermore, U.S. regulators put more regulatory obligations on the manager to check investor financial background and verify each of them to ensure that they are qualified to invest in a hedge fund.

Under the U.S., the U.K. and Korea regimes, types of investors are divided by wealth and knowledge. For example, in the U.S. and the U.K. investors are divided into two types including high net-worth investor and institution investor. On the other hand, Korea divides their investors into two types including professional investor and non-professional investor. Under the Financial Investment Services and Capital Market Act (FSCMA), "Professional investors" are investors who have the ability to take the risks accompanying the investment in light of the expertise possessed in connection with financial investment instruments.[278] Typically, a professional investor is an institutional investor such as a bank, mutual fund, or pension fund. By contrast, the non-professional investor is an individual investor who has much money to invest in a hedge fund and

[277] The Securities and Exchange Commission, "Hearing: an improvement of the rules one offering process", (อกน.18/2559)

[278] The Financial Investment Services and Capital Market, Article 9(5).

also engages in the hedge fund business. Such an individual has to take a suitability test before engaging funds. In conclusion, hedge fund investors can be divided by their financial sophistication and wealth as essential qualifications for being hedge fund investors.

Normally, Thailand divides investors into two types including institutional investor and individual investor. These two investors are different regarding experience, knowledge, and wealth. According to the conditions of hedge fund investment, it is necessary to categorize Thai hedge fund investors. Nevertheless, Thailand also has qualifications it uses to categorize hedge fund investors; it also categorize both ultra-high net worth investors and institutional investors as follows:

According to the Declaration of the SEC, the term of institutional investors is defined to include:[279]

- Bank of Thailand
- Commercial Bank
- Financial Company
- Credit Foncier Company
- Securities Company
- Insurance Company
- Life Insurance Company
- Mutual Fund
- Pension Fund
- Etc.

According to the hearing of new hedge fund rules in Thailand, ultra-high net worth investors include the following:

1. Any corporation which falls into any of these categories.

[279] The Declaration of The Securities and Exchange Commission on "The definition of institutional investor and high net-worth investor", The Securities and Exchange Commission, Kor Jor (กจ)9/2555, article 2.

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- More than two hundred million Baht worth in the Shareholder equity of the latest audited financial statement.
- More than eighty million Baht of direct investment capital in securities or future contract or bank deposit of the latest audited financial statement.

2. Any individuals with their spouse who fall into any of these categories.
    - Have assets with net worth of seventy million Baht or more, but such assets are not included as property used for daily living.
    - Have a net income of ten million Baht or more.
    - Have direct investment capital in securities or future contract or bank deposit of fifty million Baht or more.[280]

The qualifications to be an individual high net-worth investor as shown above seems that Thailand requires higher worth compare to other countries. In the U.S., an individual investor is required $1,000,000 worth and $300,000 for yearly income and South Korea requires $500,000 (0.5billion won) for any individuals willing to be hedge fund investors. Thailand on the other hand, according to the declaration mentioned above, requires higher than both the U.S. and Korea, which is $2.3 million (70 million Baht) and joint income with spouse of $330,000 (10 million Baht).

Under this qualifications, it seems that Thailand has set a good standard for the ultra-high net worth qualification because there are few people who have that much money and can qualify as hedge fund investors.

However, there is a verification procedure in the U.S. in which the fund manager must have reason to believe that such investors are high net-worth or qualified investors. The fund managers have to ask for financial documents such as financial statements; a broker-dealer confirms the net worth statement to verify an investor's status.

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[280] The Publication of the Thai Securities and Exchange Commission, "Draft publication on the definition of Ultra high net worth investor and easing an investment restriction in a non-retail investor fund." (อกน. 3/2559)

According to U.S. law, hedge fund managers are required to verify their investors before accepting any investment. Under this rule, a hedge fund manager has to accept an investment from qualified investors only. Otherwise, a hedge fund manager cannot charge performance fees from unqualified investors. Under this rule, the regulator can ensure that the hedge fund manager would accept only qualified investors.

In conclusion, the qualifications for being an ultra high net worth investor in Thailand requires higher than other countries which are outstanding compared to other countries and it is suitable to apply to hedge fund investors. Furthermore, to ensure that only qualified investors can have access to hedge fund investment, it is more efficient to set a regulatory obligation for the hedge fund manager to verify investor's financial status before accepting any investors.

4.8 Fraud against investors

Under Rule 206(4)-8, hedge fund managers are prohibited from committing fraud against investors and prospective investors in pooled investment vehicles they have managed.[281] Rule 206(4)-8 is purposefully broad to prohibit deceptive conduct that may not involve statements. The rule also covers negligent conduct, as well as reckless or deliberately deceptive conduct.

- "Prohibition on False or Misleading Statements" under the Rule 206(4)-8 it prohibits adviser to pooled investment vehicles from making any materially false or misleading statements to investors or prospective investors in those pools.
- "Prohibition of Other Frauds" the rule 206(4)-8(a)(2) also cover other types of fraud to apply more broadly to fraudulent conduct that may not involve statement such as deceptive, or manipulative act, practice, or engage in any act, practice, or course of business that is fraudulent.

[281] Rule 206(4)-8. See. Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles, Investment Advisers Act Release No. 2628 (Aug. 3, 2007), [online] available from: http://www.sec.gov/rules/final/2007/ia-2628.pdf

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In conclusion, hedge fund managers are prohibited from making any untrue statements of material facts or omitting a material fact necessary to make the statement not misleading to any investors, or engaging in any act, practice or course of business that is fraudulent, deceptive or manipulative to any investors.

Furthermore, under the Investment Adviser Act Section 206(4), the rule also cover others types of fraud such as misappropriation of fund assets, manipulating fund valuation, front running, misrepresentation in marketing and client reporting materials, market manipulation, misconduct through forging or failing to properly record trade orders, trading in violation of the law, self-dealing in allocation of profitable trades, failing to disclose material information regarding the use of soft dollars and other brokerage practice, failing to disclose personal financial interest in transactions for client accounts, failing to seek the best execution, and failing to disclose that commissions are used to compensate brokers for client or investor referrals.[282]

According to Thai securities regulations, it seems that Thailand has tightly regulated the fund rather than the fund managers. As shown in the Securities and Exchange Act of Thailand, most of the regulations tend to regulate the duties of the fund or securities companies. Meanwhile, there are a few regulations used to regulate fund managers. For instance, Section 126 of the Securities and Exchange Act of Thailand prohibits securities companies from committing certain transactions, such as engaging in any act which may create a conflict of interest.[283]

According to the Declaration of the Securities and Exchange Commission of Thailand, the duties of a fund manager as well as prohibited activities are determined to be:

- Perform duties and provide services with faith

[282] Bloomberg Law Reports, “The myth of the unregulated hedge fund”, Alexandra Poe, Esq, [online] available from: http://www.reedsmith.com/files/Publication/6add7e2f-0da5-4483-bf9d-7eea53260d50/Presentation/PublicationAttachment/a6de3c24-c01f-4962-a2da-b8ef6e0769e2/reedsmith_copy_wilmerhale_poe_rcl.pdf

[283] The Securities and Exchange Act of Thailand, Section 126.

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- Perform duties with responsibility and due care while treating investors fairly and carefully by considering investors interest as a priority
- Perform duties regarding the code of ethics and standards of a practitioner
- Do not commit any act that exploits investors or be involved in any act[284]

As illustrated above it seems Thai regulation also prohibited unlawful activities committed by a fund manager. Even though those prohibitions does not specify prohibited activities, but those prohibitions cover every material unlawful activity. Hence, under this prohibitions, it prohibits a hedge fund manager to commit any unlawful activities such as front-running, soft dollar, manipulating fund valuation, fraud, and any other activities which are harmful to investors.

Under the Declaration of Capital Market Commission of Thailand on "Business Standard Business Structure and Service of the Securities Business and Business Entrepreneur of Derivatives Contracts"[285], Article 46 provides guidelines and prohibitions for fund advertising as follows:

- Must not make false statements, overstatements, omit disclosures, or mislead in material facts
- Do not guarantee returns from the investment
- In the case of advertising by using information from others, such information must come from a reliable source with a clear reference
- If the advertisement is for the purpose of offering or selling interest in the fund, it can be done if the fund has registered with the authorities

As a result, the provision above also provided an equal standard of protection like the U.S. to protect an investor from any false or misleading statement. Thus, investors are protected from untrue statements or any misleading statements.

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[284] The Declaration of the Securities and Exchange Commission, ทลธ. 8/2557, article 23.

[285] The Declaration of Capital Market Commission of Thailand on "Business standard business structure and service of securities business and business entrepreneur of derivatives contracts" ทธ. 35/2556, article 46.

In conclusion, Thai securities regulation has provided a good protection standard to prevent any unlawful activities committed by a fund manager. Thai provisions highly regulate any information delivered from a fund manager so that such information must be correct and accurate, not misleading or overstated. Each investor is protected from untrue information. On the other hand, even Thai provisions do not regulate specifically about the prohibited activities, but the provision has covered materially unlawful activity. As a result, preventing unlawful activities committed by hedge fund manager means those provisions can be applied to hedge fund management.

Chapter 5

Conclusion and Recommendations

5.1 Conclusion

In the present day, the hedge fund industry has become one of the most important parts of the global financial market. As such, it is necessary for regulators and financial institutions to study and understand the hedge fund business and the roles of a hedge fund manager to develop Thai securities regulations that might support the needs of the hedge fund business in the future.

Hedge funds and hedge fund managers are a vital part of the financial system, but in the meantime pose a substantial risk to both the stability of the financial market and the capital preservation of investors. Meanwhile, the financial market has radically changed in the last sixty-five years with increased globalization and technology sophistication, while the law and governing securities have not.[286] Under the current Thailand regime, there is no regulation applied to hedge funds and hedge fund managers. If efficient regulations are applied to hedge funds and hedge fund managers, the SEC would have the ability to identify fraud, misuse of leverage, and speculation from some of the risks that the hedge funds and hedge fund managers pose to investors and global economic market. There is no doubt that some regulations for hedge funds and hedge fund managers are necessary.

To make the regulations more efficient while preserving the competitive advantage of hedge fund business, preserving the solidity of the national and global economies from the systemic risk of correlated hedge fund failures, second, protecting investors, more specifically pension funds and mutual funds, and then individual investors, unsophisticated investors, third, deterrence of fraud is necessary. The proposed solution attempts to remedy concerns while minimizing the cost of

[286] "Protecting global financial market stability and integrity: strengthening SEC regulation of hedge funds", Thomas C. Pearson, Julia Lin Pearson, North Carolina Journal of International Law and Commercial Regulation.

compliance. The appropriate solution to these problems within the hedge fund industry is to require a hedge fund manager to register with the SEC. The registration would give the SEC necessary information to begin to understand the hedge fund industry and attempt to curb some of the illegal activities of hedge fund managers. Also, registration will prevent market disruptions by monitoring a fund's activities. Moreover, registration will allow the SEC to observe more efficiently and handle threats posed by hedge fund managers.

The words "hedge fund" are used to describe an investment vehicle with great flexibility in the investment strategies it can adopt. Usually, these strategies are unavailable to a traditional mutual fund. In the past, a hedge fund started from a hedging technique, which takes a long position in one asset and at the same time takes a short position in another asset to compensate for loss from one another.

There is no legal definition of a hedge fund, but it can include such characteristics as follows:

- Hedge fund investors are restricted to only qualified investors who are wealthy individuals and institutional investors
- Use flexible investment strategies
- Hedge fund uses high leverage and derivatives to generate more return
- Hedge fund manager also puts his own money in the pool of assets
- Hedge fund has two fees including management fee and incentive fee, which depend on the return the hedge fund manager can generate

A hedge fund manager is a person who takes a significant role in the fund by making investment decisions and managing the fund, which affects the satisfaction and safety of investors. However, there are still some issues in the role of a hedge fund manager that should be taken into account, such as conflict of interest, fund transparency, fraud, disclosure of material information, and, investor verification. These issues affect the public interest, which results in subsequent legal measures.

Nevertheless, studies about the roles and duties of a hedge fund and hedge fund manager have compared them to a mutual fund and a mutual fund manager. They found that the core of a hedge fund business and a mutual fund are similar, as are their

managers. Furthermore, they categorize hedge fund managers and mutual fund managers in foreign countries as investment advisers, so both have to comply with the same rules. As a result, providing legal measures for a hedge fund manager means some parts of mutual fund regulation can be applied to hedge fund management.

5.2 Recommendation

If hedge funds take root in Thailand market, it will be able to improve Thailand market intensity and efficiency as a financial venture industry. Moreover, a hedge fund industry will help create the alternative investment market, and promote the quantitative as well as qualitative of the asset management industry. Furthermore, a hedge fund can vitalize the whole financial industry by helping mature professional manpower in hedge fund related areas.

As mentioned before, both hedge fund managers and mutual fund managers have similarities in many ways, whether in roles or duties, which result in similarity in terms of regulatory oversight. However, a hedge fund is the special investment vehicle which has a flexibility investment as a competitive advantage. Also, it is only available for a specific type of investor. A hedge fund is a kind of private financial product. Thus, the level of general regulatory oversight between a hedge fund manager and a mutual fund manager should be different. In that regard, a hedge fund manager should be regulated similarly to the mutual fund manager in terms of investor protection to prevent any harmful activities against the investor.

Studies on legal measures relate to the roles and supervision of hedge fund managers in Thailand by considering availability and the regulatory model while comparing the regulatory requirement of a hedge fund manager in foreign countries. It can conclude that tightly regulated hedge fund managers, rather than the hedge fund itself, would be more efficient because the hedge fund manager is the one responsible for the fund’s daily investment and management activities. On the other hand, the core hedge fund business is not different from the mutual fund business, as well as the regulations used to regulate the fund managers. Thus, the author suggests a guideline for measures to regulate hedge fund managers in Thailand by adopting some part of mutual fund manager regulation as a solution.

5.2.1 Hedge fund manager registration

Regulating hedge fund managers by requiring them to register with the authority is premised on the grounds that the negative impact on the market could be controlled and managed by regulating hedge fund managers because they are the very persons that have unlimited discretion in investing and managing a fund's assets. Furthermore, this regulatory model has been adopted by some jurisdictions including the U.S., the U.K., and Korea.

Under the Thai regime, a fund manager is required to register with the SEC, whether a mutual fund manager or a private fund manager. However, there is no category for hedge fund manager licensing. To solve this problem, a hedge fund manager should be subject to the same category as a mutual fund manager. In many countries such as the U.S., the U.K., and Korea, this regulatory model has been used to subject hedge fund managers to the same category as a mutual fund manager. For example, the U.S. classes a hedge fund manager and a mutual fund manager as investment advisers, which requires them to undertake the same registration process. Under this approach, some part of the regulation may apply to both hedge fund manager and mutual fund manager. It is also easier for the regulator to categorize a hedge fund manager as an investment adviser like a mutual fund manager. Those regulatory obligations may be relatively lighter or tighter in some areas than those applied to mutual fund managers. However, a Thai regulator has the authority to enact additional regulation for hedge fund managers in the future. The SEC in Thailand already used this method in other funds. Basically, the general regulation will apply to a mutual fund manager and the specific or additional regulation will apply to the fund manager who has a specific purpose such as REIT, pension fund, and gold fund.[287] Hence, any issue about hedge fund management may be converged into this direction eventually. Because regulatory efforts should be made to treat them more like a mutual fund

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[287] Yuwadee Amornsirivipa, "Legal Measures on Encouraging and Regulating Hedge Funds" Master of Law program in Finance and Tax Laws, Chulalongkorn University.

manager, both have similarities in nature and substance. Meanwhile, there are slight differences between them based on the regulatory concerns that exist in both industries.

The Thai SEC is currently in the process of hearing arguments to ease some of the investment restrictions. Under the new proposal, the fund could make an investment without any restriction. The fund would be regulated similarly to a mutual fund. In other words, the fund would have some similarities and differences with a foreign hedge fund in the term that each investor must be a high net worth investor or institutional investor. Moreover, both would be regulated by the same authority. In conclusion, the fund may have more investment ability under the new proposal, which makes it possible to invest in various kinds of assets, but may be available for a specific type of investor. Meanwhile, it would be regulated similarly to a mutual fund.[288]

The registration would give the authorities the size of assets under management of the hedge fund industry in Thailand. It is a necessary tool to assess the systemic risk. With the increase in the size of hedge funds and their roles in the financial market, it becomes crucial to keep an eye on their size, portfolio, and leveraged positions on an ongoing basis. By doing so, the SEC can take appropriate measures to prevent or mitigate any potential market disruption promptly. Moreover, the registration would provide several benefits, such as increased disclosure standards to create a more efficient market, and also ensure that a hedge fund manager complies with fiduciary duties. It will also enable the SEC to protect financial market stability.

Lastly, the recommendation of this author is to subject a hedge fund manager as an investment adviser or in the same category as a mutual fund manager, which requires obtaining a license and registering with the SEC before operating their business. Also, it would be easier and more efficient to simply apply a mutual fund manager's registration process to a hedge fund manager as well as some part of the mutual fund manager's regulation to a hedge fund manager.

[288] The Publications of the Thai Securities and Exchange Commission, "The easing investment restrictions of the mutual fund that offered to non-retail investor" (อกน.19/2558)

5.2.2 Disclosure obligations

A hedge fund manager should be subject to mandatory disclosure similar to mutual fund managers. It would be easier and simple for the regulator to apply a mutual fund manager's disclosure requirement to a hedge fund manager. Both of them have similarities in nature and substance, which should be regulated similarly. However, a hedge fund and mutual fund are not exactly the same. There are differences regarding risk and complexity. Hence, there should be some additional disclosure requirements in terms of the disclosure requirement for a hedge fund to disclose additional information regarding its risk. Moreover, such additional information should be provided in the prospectus and should consist of a certain type of information such as investment strategy, worst case scenario analysis and maximum loss, as well as the actual maximum loss from the previous year, risk management system, and risk spectrum. From the point of view of this author, a hedge fund manager should be subject to the disclosure requirement like a mutual fund manager by requiring them to provide a prospectus to investors. Meanwhile, a hedge fund is a risky and complex investment vehicle, making it very difficult to understand and assess for risk. Thus, the hedge fund disclosure standard should be higher than for a mutual fund by requiring additional information to ensure that each investor understands and is informed regarding the risk of investment.

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5.2.3 Reporting obligations

Thailand already has a general reporting requirement it uses to monitor systemic risk. These reporting requirements are applied to a mutual fund. According to the new proposal of the Thai SEC, a hedge fund is also subject to the reporting requirements similar to a mutual fund. It requires a hedge fund to report the fund's operation to the SEC. However, a hearing of the SEC stated that the authorities might add additional rules for a hedge fund. The rules might apply to some hedge funds that have the strategy to invest significantly in a future contract. Such a hedge fund might be required to report additional information such as value at risk, stress test, and back test result to the authorities. From the point of view of this author, such a reporting requirement is

sufficient to monitor the hedge fund business because it requires necessary information regarding investment risk.

5.2.4 Restrictions on marketing

In many countries, hedge funds are required to offer their fund to a specific type of investor. In other words, they are restricted to offering the fund to non-retail investors unless there is an exemption available. Even so, a hedge fund in Thailand may fall into the same category with a mutual fund, so most of the mutual fund regulations would be applied to a hedge fund. According to a hearing of the Thai SEC, the mutual fund offering process might not apply to a hedge fund. Thus, a hedge fund might be restricted to offer their fund only to a specific type of investor. In addition, an additional requirement should apply to a hedge fund due to the risk and complexity of a hedge fund. First, the sales person must do a "know your client analysis" during the sales process to ensure that the investor is suitable for the hedge fund. Second, it is necessary to ensure that the investor is informed about the risk of investment as well as the maximum loss that might occur in a worst case scenario. Third, the sales person must explain about the risk and warn their investor before investing in a hedge fund. Lastly, the prospectus must be available for the investor.

5.2.5 Investor qualifications

To protect individual investors, it is necessary to screen investors who can invest in a hedge fund because the core business of hedge funds is different from other funds, which an individual investor is not familiar with. Furthermore, a hedge fund engages several types of securities and usually has highly complicated securities such as unrated assets, futures contracts, options, swaps, and commodities. As a result, a hedge fund manager may sometimes invest in very risky assets that are not suitable for unsophisticated investors. Alternatively, they might suffer massive loss from the investment if they put all their money in the fund. To protect individual investors, a high qualifications for hedge fund investors should be set.

It is necessary to have an investors' qualifications for a hedge fund manager to comply with before accepting any investment from investors. According to the new

proposal of the Thai SEC[289], an investor qualifications for ultra-high-net-worth investors is set. Considering the qualifications, it seems that Thailand set an investors' qualifications standard higher than other countries, which is sufficient to prevent unqualified investors from making an investment in the fund. As a result, it appears Thailand already has a good investor qualifications standard.

5.2.6 Investor protection

Under the Declaration of Capital Market Commission of Thailand on "Rules on Personnel in a Capital Market", Article 23 prohibits a series of activities such as overstatements, omit to disclose, false statements, misleading, and conflict of interest.[290] Moreover, Article 46 of the Declaration of Capital Market Commission of Thailand on "Business Standard Business Structure and Service of the Securities Business and Business Entrepreneur of Derivative Contracts," provides a guideline and prohibition for fund advertising, which includes not making false statements, overstatements, omit to disclose or misleading, etc. [291]

As a result, the provision above also provides the same standard of protection as I the U.S., which protects an investor from any false or misleading statements. Thus, investors are protected from untrue or misleading statements. In conclusion, Thailand has provided a good protection standard to prevent any unlawful activities from being committed by fund managers. It highly regulates any information delivered by a fund manager so that such information must be correct and accurate, as well as not misleading or overstated. Thus, each investor is protected from untrue information. On the other hand, even Thai provisions do not regulate specifically about prohibited

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[289] The Draft declaration of the Thai SEC, "Qualifications and definition of Ultra high net worth (UHNW) and the easing investment restrictions of the mutual fund that offered to non-retail investor" (อกน.3/2559)

[290] The Declaration of Capital Market Commission of Thailand on "Rules on personnel in capital market" (ทลธ. 8/2557)

[291] The Declaration of Capital Market Commission of Thailand on "Business standard business structure and service of securities business and business entrepreneur of derivatives contracts" ทธ. 35/2556, article 46.

activities. However, the provision has covered every material unlawful activity. As a result, preventing unlawful activities committed by hedge fund managers means these provisions should be applied to hedge fund management.

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APPENDIX

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