

**EDHEC Alternative
Investment Days
2007**

Bringing Academic Insights to
Alternative Investment

**16:30-18:00
Stream 2E:
The Listing of Hedge Funds**

Chairman:

Dan Waters, Director of Retail Policy, FSA and Advisory Board Member,
EDHEC Risk and Asset Management Research Centre

Speaker:

Jean-René Giraud, Director of Development,
EDHEC Risk and Asset Management Research Centre

Panellists:

Daniel Godfrey, Director General, The Association of Investment Companies

Odi Lahav, Head of the European Alternative Investment Group,
Moody's Investors Service

Duco Wildeboer, Manager, Listing Department, NYSE Euronext

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The Listing of Hedge Funds

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Agenda

- Principles of hedge fund listing
- European market perspective
- Rationale for going listed
- Foreseeable and unforeseeable consequences
- Concluding thoughts

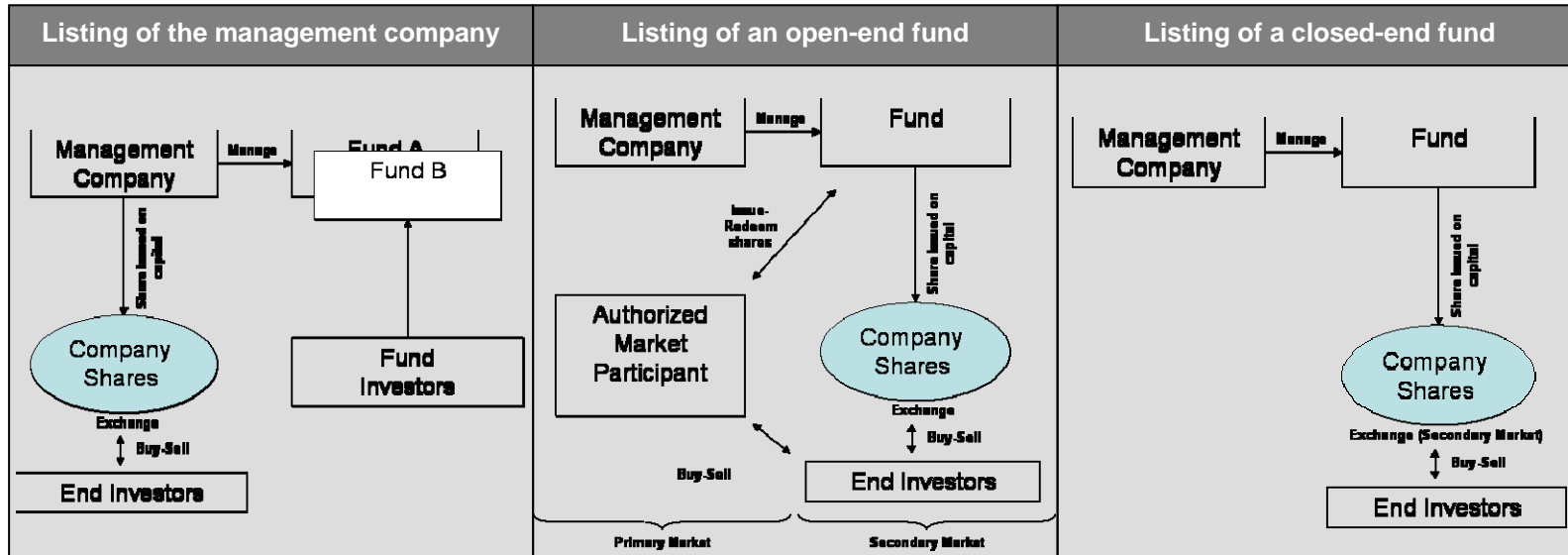
Principles of hedge fund listing

The listing of hedge funds is an innovative way for funds to raise long-term capital from investors and ease the commercialization of hedge fund vehicles

- The listing of hedge funds is developing in Europe on the back of the commercial success of Exchange Traded Funds and the listing on regulated exchanges of other investment vehicles such as property funds.
- The main aim for the issuer is to access locked long-term capital from a larger investor base and move away from the past 'investor's club' model that is restricting the development of the industry.
- The following listed vehicles are often confused:
 - Listing of the management company
 - Listing of an open-end fund
 - Listing of a closed-end fund

Principles of hedge fund listing

A number of concepts ought to be clarified in order to properly understand what approaches are available and what it involves for both the issuer and the investor



- These three models exhibit significant differences when it comes to the nature of the income and the valuation of the shares and the way they are traded on the regulated exchange.
- It is also important to clear up the confusion between ‘listing’ and ‘trading’.

Principles of hedge fund listing

Those models exhibit significant differences for all parties involved in the process

Characteristics of the listing depending on the nature of the share issued

	Management Company	Open-end fund	Closed-end fund
Nature of shares	Shares of a company	Shares of fund with variable capital	Shares of fund with fixed capital
Assets invested in the underlying investment strategy	No (except management company's shares if any)	Yes	Yes
Factors impacting upon share performances	Economic outlook of the management company: •AUM & Fee levels (+) •Financial strength •Expected commercial growth Indirectly returns of the underlying investment strategy (impact on AUM).	Primarily returns of the underlying investment strategy. AUM & Fee levels (-). Possibly arbitrage on asset valuation.	Returns of the underlying investment strategy. AUM & Fee levels (-). Supply & demand and market friction (liquidity supply). Estimates of future outlook of the strategy (premium or discount). Possibly arbitrage on asset valuation.
Tracking error with NAV	Irrelevant	Limited (arbitraged)	Possible

- In this presentation, the focus remains on closed-end funds or closed-end funds of hedge funds.

European market perspective

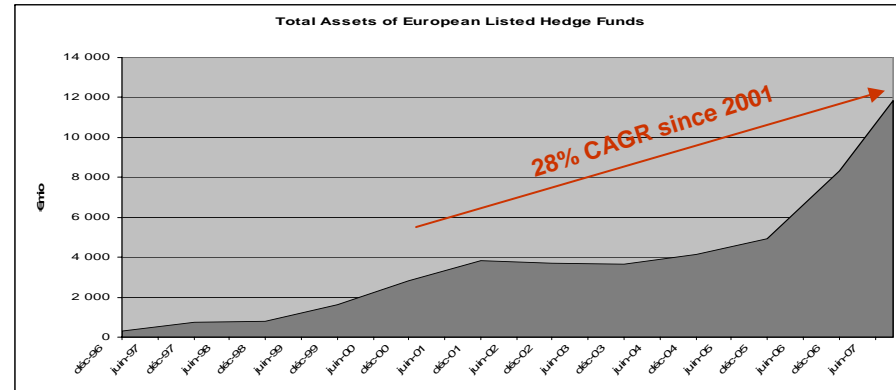
The European market has been a precursor in alternative investment listing and is enjoying significant growth and competitive development

- Raising permanent capital is not a new idea
 - First listed fund in 1996 on the LSE: Alternative Investment Strategy (International Asset Managers), followed rapidly by Dexion Absolute (\$1 Billion)
 - A trendy option since 2006: LSE listed hedge fund assets went from \$3 Billion to \$5.4 Billion with recent IPOs (CMA Global Advisors closed FoHF with \$402m, Goldman Sachs Dynamic Opportunities fund with \$507m, etc..)
- Other European exchanges have enjoyed similar growth
 - NYSE Euronext (Amsterdam) is the favorite, benefiting from the FSA ban on listing single strategy hedge funds with for example Boussard & Gavaudan \$562m and Marshall Wace Tops €1 Billion ...
 - Toronto, Sydney, Dublin and Zurich are other exchanges listing hedge fund vehicles.

European market perspective

With approximately 50 funds listed, the European market is currently the largest market for listed hedge funds with total assets raised in the region of €12bn

- The sustained growth in FoHF listing over the last decade is currently being further supported by the issuance of single manager funds on major exchanges.



Date	Fund of Hedge Funds (€mio)				Hedge Funds (€mio)			Total
	Zurich	London	Other	Total FoHF	Euronext	London	Total HF	
31/12/1996	257	52	0	309				309
31/12/1997	569	58	118	745				745
31/12/1998	664	60	86	809				809
31/12/1999	1 456	85	100	1 641				1 641
31/12/2000	2 644	103	81	2 828				2 828
31/12/2001	2 848	885	77	3 810				3 810
31/12/2002	2 697	941	60	3 698				3 698
31/12/2003	2 707	864	83	3 655				3 655
31/12/2004	2 568	1 445	132	4 145				4 145
31/12/2005	2 388	2 337	147	4 872		74	74	4 947
31/12/2006	1 692	4 454	122	6 267	1 903	140	2 043	8 310
03/09/2007	1 834	5 616	273	7 723	2 660	1 470	4 130	11 852

Source ABN Amro Bank NV

European market perspective

The strong positioning of London as a global centre for hedge funds is confirmed as far as listing of funds of hedge funds on regulated exchanges is concerned

- London keeps its leading position for fund of hedge funds listing despite stricter rules and a number of initiatives have been taken to respond to the dominance of NYSE Euronext Amsterdam in relations to single hedge funds.
 - Record £1.4bn raised in 2006 for London-listed fund of hedge funds, more than doubling the sector's value to £3.3bn (end 2006).
 - Funds outside the rules went for an AIM listing
 - RAB Special Situations, Bluecrest
 - Less liquidity though
 - The Specialist Fund Market
 - A market for alternative asset listing filling the gap between the LSE and AIM and open to international funds opening this November

European market perspective

But the regulatory agenda is rapidly filling with initiatives aiming to prevent historical markets from gaining a dominant position in the FoHF listing or the single manager's market

- Competition between the London Stock Exchange and Amsterdam-based Euronext for new listings has been especially fierce.
- After London lost out on several high-profile listings last year, the UK's Financial Services Authority announced a controversial reinterpretation of its rules in October that allowed foreign closed-end funds to list with the minimum requirements under European law.
- The introduction of MiFID on 01/11/2007 is also likely to trigger the development of innovative hedge fund trading platforms likely to compete with traditional regulated exchanges.

The rationale for going listed

Listing a corporation or a fund involves a number of constraints but brings a fair number of very compelling advantages for the issuer

- Access to quality capital for the issuer
 - The fixed capital structure allows the issuer to avoid a number of significant issues especially when the underlying investment strategy involves non-liquid assets or requires long-term capital commitment. As such, the listing of hedge fund resolves a critical ALM issue that currently is the root of a number of key risks for unlisted vehicles.
 - The administrative complexity of listing a hedge fund is counterbalanced by a significant simplification of the NAV determination process which is not impacted by subscription/redemptions (equalization ...).
 - Finally, the listing of a flagship fund allows the management firm to benefit from quality market exposure and strong visibility as well as access to a broader range of investors.

The rationale for going listed

These advantages are completed by a number of additional features that are likely to support the promotion of hedge funds to a larger investor base

- Access to simpler investments for the investor
 - Shares in hedge funds are securities that can be traded daily on the secondary market and settled through a well-documented and organised process rather than through a tedious paper-based settlement procedure.
 - Listing on regulated markets requires minimum levels of transparency and disclosure that are compelling in comparison to private partnerships.
 - Liquidity restrictions related to the underlying investments and all risks associated are transformed into a liquidity premium or discount that is priced into the market and contained thanks to arbitrageurs that have a better understanding of the underlying investment strategy.

The rationale for going listed

But also ...

- Compelling costs compared to financing through bond issuance
- Listed hedge funds are securities eligible to a larger number of investors.
- Availability of hedge funds on the secondary market will support the development of guaranteed products based on portfolios of hedge funds as those investments can be easily hedged.
- Listed hedge funds offer a compelling access to hedge fund indices provided the universe is representative enough.

Foreseeable and unforeseeable consequences

But listing does not solve all problems and the long experience with listing of corporate firms has demonstrated that markets may amplify idiosyncratic issues in certain circumstances

- For Issuers
 - Price less related to performance (versus NAV)
 - From January to April 2007, the number of LSE sterling listed funds trading at a discount increased from 14 to 17 of the 26 (average discount increasing from 3.1% to 4.1%) while only 3 got negative performances in the same time frame.
 - Compared to the closed-end fund sector, hedge funds are trading at only half the discount of their peers.
 - Success of IPO linked to market confidence
 - Volatile markets can affect IPO (summer 2007).

- For Investors
 - Issue of discount for selling
 - Shares might be affected by general market movements more than by investments held.

Foreseeable and unforeseeable consequences

More generally, listing of hedge funds and determination of a market price on exchange with full liquidity may involve some negative consequences that ought to be closely monitored

- A number of adverse effects can be expected or should be closely monitored:
 - Flight to ‘bad’ quality (e.g. investors selling quality assets when investments in sub-prime hit but could not be liquidated) – risk of market contagion.
 - Unreasonable market movements due to the difficulty of assessing the intrinsic value of the fund when the underlying strategy involves illiquid or hard-to-price instruments.
 - Moral hazard implied by the regulatory regime focused on transparency and disclosure only rather than on independent oversight.
 - Creation of a two-tier industry with weaker funds raising capital through IPO and strong funds remaining in the form of private partnerships.

Concluding thoughts

Suggested questions

Below are a number of suggested questions for the panel, as agreed please let us know which questions make sense for each of you and feel free to add any suggestion/amendment.

1. What level of regulatory oversight seems reasonable on an investor's perspective?
2. How does HF listing compare to bond issuance for raising capital?
3. Does listing actually increase the level of transparency (listing rules & requirements) for investors?
4. Do you think market makers and other market participants will be in a position to evaluate the fair value of a fund with sufficient precision in order to arrange for smooth trading?
5. What are the risks with the fact that those investments are likely to be sold to retail investors?
6. Will hedge funds listed on regulated exchanges be eligible to UCITS III funds outside of the limit put on alternative investments?
7. Do you expect new execution platforms to develop under the MiFID regime (Multilateral Trading Facilities) that would allow shares in un-listed hedge funds to be exchanged at a market-determined price?
8. Is the level of transparency required to list single manager hedge funds likely to become a barrier to entry for the vast majority of funds?
9. Is there a risk that indices on listed funds attract assets in too large amounts, resulting in an imbalance between supply and demand, hence in undesired market premiums?
10. Is there a risk that weaker managers use the opportunity of raising capital through IPO to benefit from a lower level of investor due-diligence?

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