OPALESQUE
Premium Alternatives News

Don’t regulate U.S. hedge funds too much or they’ll go shopping elsewhere: Butterfield Fulcrum

Many hedge funds are now preparing for the registration requirements that come with the Dodd-Frank Wall Street Reform and Consumer Protection Act, ahead of the March 30th registration deadline with the SEC. Some say that many are lagging behind in the preparation for filing Form PF, a disclosure requirement also from Dodd-Frank, that must be fulfilled this summer or next year. Most are also bracing for the Foreign Account Tax Compliance Act (FATCA), even if full implementation won’t be until 2015.

This wave of regulations can’t be fun if you’re a hedge fund. Even if the Volcker Rule, part of Dodd-Frank and aimed at curbing investment banks’ proprietary trading, will give more market space for hedge funds to play with.

Todd Groome, Chairman of the Alternatives Investment Management Association (AIMA), told Opalesque a few months ago: "We are an entrepreneurial industry and that is a benefit for our industry and for markets. Policy makers focused on financial stability should not regulate everyone like a bank. If everybody is incentivised by regulation in the same way, that may actually create increased systemic risk. You want to create diversity in markets – the more diverse, the healthier."

There has indeed been an extreme growth of regulation and the complexity of it went "exponential"… from a simple one-pager to a lawyer’s nirvana, Alexander Ineichen, founder of Swiss-based Ineichen Research and Management, told Opalesque. For example, where the U.S. Glass-Steagall Act (1933) had 37 pages, the Dodd-Frank Act (2010) is around 848 pages long.

The upcoming presidential election in the United States has the potential for further major impact on the future trajectory of the regulation and the very competitiveness of the U.S. as an alternative investment jurisdiction could very well hang in the balance, says Phil Niles, Director, Product Development at Butterfield Fulcrum, a top five fund administration company, in a release today.

There have been many regulatory changes to contain banks that also affect the alternatives industry: Dodd-Frank, FATCA, Form PF are some of the main regulatory changes that hedge funds will have to deal with – and pay dearly for, with time and money. Niles cites highly-regulated Canada, which alternative investment industry is relatively small "with the regulatory burden currently in place cited as a primary cause."

The regulatory bodies of the U.S. are very much at a crossroads with the alternative investment community, he continues. They have to keep a fine balance, as if they go overboard, the mobile personnel of this globalised industry will have no problem moving to other jurisdictions. And, he points out, there are many jurisdictions which are more than willing to welcome some of the assets – and the people – currently domiciled in the U.S.

"If the incentives given by a foreign domicile (or if the *dis*incentives in place in the United States) were sufficient, billions of dollars could move offshore for good along with untold numbers of well-educated workers with high-paying jobs," he explains.

Capital goes where it feels welcome, Niles quotes former U.S. congressman Mark Kennedy as saying.

He recommends to "those with their names on a ballot this year" to take note of this flight risk and ensure a proper approach to regulation and compliance. The alternative investment industry is flexible, and if regulators cannot give it a flexible structure, it "could go shopping for a new, more adaptable partner."

Outside of the presidential contenders arena, small adjustments are being made to encourage the financial industry, directly or not: for example, we recently heard that a Pennsylvania City Councilman Bill Green was sponsoring a bill that exempts private investment or hedge funds and their general managers from paying business taxes; and that House Majority Leader Eric Cantor on Wednesday unveiled The Small Business Tax Cut Act, which would grant a one-year 20% cut on taxes paid by small businesses, defined by the federal government as companies that employ fewer than 500 people.

The game of push and pull will reach its climax when all new regulations are implemented, by around 2015 (if things stay the same). We will see then if the industry really wants to leave the U.S.