De Facto Regulation of Hedge Funds Through the Financial Services Industry and Protection Against Systemic Risk Posed by Hedge Funds

By Isaac Lustgarten

The hedge fund industry is regulated in several ways, none of which alone or together enables government regulators either to understand the systemic risk of one or more funds or to intervene to avoid systemic risk. No method of hedge fund regulation (except for capital requirements) will protect against systemic risk. Capital requirements might be difficult to impose because hedge funds may move offshore, and rapid changes in hedge funds risk positions could make capital requirements difficult to apply. However, aggregated and masked hedge fund risk positions will enhance the ability of counterparties to withstand hedge fund-triggered losses. The implosion of a hedge fund or the losses of many investors is not systemic risk. The Federal Reserve considers systemic risk to be a risk that threatens one or more financial institutions and thereby the stability of the system.

Hedge funds are regulated through:

1. Investor protection measures (including threshold limits for investment, antifraud protection, *etc.*);
2. Light regulation of hedge fund *managers*;
3. Operational risk ratings of funds that have opted to be rated by a ratings agency;[1]
4. Market discipline through public information of hedge fund managers and hedge funds that are SEC-registered issuers;
5. The best practices industry guidelines for fund and fund managers;
6. Litigation; and
7. Bank and securities regulators' guidelines for managing the risk of an individual financial services firm's relationships and transactions with hedge funds.

This article focuses on this last method of indirect delegated regulation as the one that comes closest to a US regulator's supervising of hedge fund risks. However, this delegated method of supervision should and can be enhanced (via methods that exist in the marketplace) if it is to be used as a useful measure of systemic risk.

This article discusses:

- Risks posed by hedge funds;
- Financial firms' activities with hedge funds;
- The difficulty in regulating a hedge fund flows from the difficulty of defining one;
- Hedge fund regulation in the United States;
- Hedge fund manager regulation;
- Banks and brokerage firms are the *de facto* supervisors of hedge funds;
- Risk measurement techniques: aggregation of information;
- Reporting of investments made by hedge funds;
- Regulation of other financial services companies;
- The costs of regulating and supervising hedge funds; and
- Litigation and regulatory investigation as a form of regulation.

This article also briefly discusses, as a point of comparison, the regulatory structure applicable to other financial firms. In brief, the securities and banking regulators have a direct method for gauging the risks of a bank or investment bank individually and its impact on the

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system and do not have the same ability with respect to a hedge fund.

Regarding points (1) and (6), there is some correlation, as seen from a legal, financial, or economic perspective, between investor protection and protection against systemic risk. Therefore, the attempts to ensure that hedge fund investors are sophisticated and to improve disclosure about a hedge fund manager may, to a limited extent, contribute to the protection of the financial system from one or more hedge funds' providing hedge fund counterparties with miscalculations, but these measures are not the cure for systemic risks. Similarly, regulation of a hedge fund *manager* (through registration, disclosure, even the public offering process) is meant to protect the investor and is a relatively small factor in strengthening the financial system.

Regarding points (2), (4) and (5), these methods simply do not yield sufficient or relevant information for systemic risk management because they do not provide counterparties with real-time information about risk positions. Instead, these methods provide information about the manager's experience, investment style, and, perhaps, operational protections.

Regarding point (3), the operational rating of a hedge fund by a ratings agency is useful for the manager and the investor, but not necessarily for the system. Moreover, ratings agencies have had a poor record in signaling weaknesses in other financial services firms.

Regarding point (7), the US regulators have left the burden of hedge fund regulation primarily to financial services firms. The cost to a bank or broker-dealer to (1) develop an infrastructure to deal with information about hedge funds and (2) to perform due diligence and gather information about hedge funds is not clear. Although not the subject of this article, one assumes that such cost properly is being transferred to hedge funds and their investors (*i.e.*, the people who benefit most from the funds' receiving services from banks and broker-dealers). Nevertheless, the G7 Finance Ministers on May 19, 2007, through the Financial Stability Forum (FSF) and the President's Working Group (PWG), have recommended against regulating hedge funds directly.[2] Instead, the PWG and FSF have essentially delegated hedge fund regulation to primary brokers and dealers. Banks and broker-dealers are not the best (or only) delegates for regulating hedge funds, especially given their conflicts of interest, to increase business with hedge funds and their competition with hedge funds.

Regulators may obtain a picture of the systemic risk one or more hedge funds pose through the prism of one or more financial services firms. There are ways (including through currently available methods) for the "regulatory system" to obtain knowledge about high-impact hedge funds through the system's delegates. Information about hedge funds positions can be aggregated and masked. The Securities and Exchange Commission (SEC) and the Federal Reserve Board (Fed) have each said that the most desirable way for financial services firms to manage risks posed by hedge funds would be a market-derived system (not explicitly endorsed by the regulators) in which masked aggregate positions and trends would be available to financial services firms.

If you asked financial journalists, most would describe a hedge fund as a secretive unregulated investment vehicle for wealthy private and institutional investors. This description ignores what hedge funds do and whether (or how) they are distinguishable from other investment vehicles. This description also ignores whether hedge funds are in fact, if not by law, regulated and for what purpose they might be regulated. Originally, a hedge fund's primary goal was to take positions whose returns were not closely correlated to the broader financial markets.[3] The PWG report[4] restates the current state of hedge fund regulation (*i.e.*, regulators rely on financial services firms to supervise hedge funds, and the regulators do not have as complete and accurate picture of the hedge fund industry's potential impact on the financial system). This approach stems from the general view that hedge funds pose systemic risk, not by their own failure or by losses of investors in the funds, but if the funds' failure were to pose a risk to the stability of a regulated financial institution.

Generally, there are two purposes for regulating a financial services company: (1) investor protection and (2) protection from systemic risks. This ignores the increasingly important role played by non-regulated financial institutions and the various forms of credit assumed or extended by non-regulated participants.

Risks Posed by Hedge Funds

Hedge funds pose credit, trading, legal, and reputational risks in the following scenarios.

- The risks hedge funds pose derive from the various roles that they play, as borrower, lender, investor, investee, brokerage and swaps counterparties, etc. The amounts at stake, even if quantifiable, can be meaningless because the hedge funds typically refuse to divulge their risk positions. Imagine, for example, a mortgage lender granting credit to a home purchaser knowing the existing liabilities of the home purchaser and not knowing whether such liabilities are a yacht, credit card debt, other real property, or investment grade securities.
- Individual hedge fund failures give rise to credit risk and affect financial firms both as lenders and counterparties to hedge funds, both directly and indirectly, through the impact of hedge fund failure on other market factors to which the financial firms are exposed.
- A slowdown in the hedge fund industry caused by weak market performance or regulatory tightening could give rise to trading risk, as funds may increase their leverage to generate returns in line with investor expectations and are encouraged by fee structures skewed toward performance.
- The window that regulators have directly into other financial services companies does not exist in the hedge fund context; there are no capital requirements to act as a cushion against a hedge fund's losses, and there is no way for a regulator to know or manage the aggregate of a fund's positions. The gaps in regulations described are illustrated by a recent case in which a prime broker (Bear Stearns) was charged with responsibility for its counterparty fund failure. (Discussed later in this article.) Hedge funds are technically largely unregulated, but arguably, they are in fact regulated through various means such as litigation, market discipline and competition, and through the due diligence conducted by counterparties. The question is whether this regulation is sufficient to avoid a systemic problem.
- Potential conflicts of interest when financial institutions have multiple relationships with hedge funds (service provider, lender, investor, investee, manager, competitor) may give rise to legal or reputational risks and may lead to demands for preferential treatment when a hedge fund is a substantial investor or customer (as in the market timing and late-day trading scandals).[5]

As this article argues, the key is for hedge fund counterparties, not the regulators, to know a hedge fund's risk positions and the risk positions of the industry as a whole and to manage its exposure to an individual fund based on that knowledge.

Systemic Risks

Additional risks face the financial services system as a result of hedge fund activity as a whole, including:[6]

- The potential for rapid outflows from the sector if hedge funds come to be viewed as unable to deliver the returns expected by investors;
- The possibility that the failure of a major hedge fund or group of funds could significantly damage the viability of a major financial institution, both through direct losses and indirect losses resulting from the failure's impact on other market risks;
- The possibility that the collapse of a large and highly leveraged hedge fund could threaten the solvency of many financial institutions and result in an overall market crisis, similar to the possibilities that were feared if LTCM had been permitted to fail;
- The possibility that financial institutions could face a liquidity crisis if they must pay on large and numerous credit default swaps sold to hedge funds relating to a particular prominent issuer (for example, General Motors);[7] and
- The possibility is that one or more leveraged counterparties (such as hedge funds) do not have sufficient funding liquidity to meet margin calls and dealers close out their positions. The closeouts and heightened risk aversion can then erode market liquidity and adversely affect prices in a broad range of financial markets.

An indirect systemic risk scenario for hedge funds would work as follows. The issue is:

> whether other leveraged counterparties, including large dealers and hedge funds, are willing and able to stabilize markets by taking contrarian positions or providing liquidity. If not, the resulting market illiquidity can adversely affect financial market participants in a number of ways. Large dealers would be affected through losses on the part of

> leveraged counterparties to which they have credit exposure and through losses on their own market risk exposures. Losses on these exposures, in turn, can lead to further risk aversion and liquidation of positions. Other participants will find the liquidity of their balance sheets reduced, which could lead to further fire sales or a reluctance to transact. Solvent but suddenly illiquid market participants may default on their obligations. If the disruption to markets lasts long enough, borrowing and lending for real investment could be curtailed.[8]

So far, a hedge fund's actions have not lead to systemic risk.

Assistant Treasury Secretary Ryan has defined systemic risk "as the potential that a single event, such as a financial institution's loss or failure, may trigger broad dislocation or a series of defaults that impact the financial system so significantly that the real economy is adversely affected." This systemic risk is *not*, for regulators' purposes, the loss by investors of money. Although it is arguable that with enhanced risk management techniques and derivatives the potential for systemic risk has decreased, "the potential damage that could result from such shocks is greater due to the increased spread, complexity and tighter linkages that characterize the global financial system."[9] Several factors contribute to the greater potential for systemic risk: easy credit and leverage; highly correlated strategies; connected and concentrated lenders; inadequate information; and underdeveloped financial market infrastructure. Leverage has increased via borrowings and derivatives, correlation has risen in hedge fund returns resulting from a decrease in return hedge fund volatility, which can become denoted during periods of market stress, the concentrated and connected network of core financial institutions that serve as the principal counterparties and creditors to hedge funds has become more complex and intertwined, and inadequate information about counterparty hedge fund risk positions and financial market infrastructure increases.[10]

Ryan also summarizes his views on minimizing systemic risk:

- Counterparties and creditors must maintain appropriate policies, procedures, and protocols. They must clearly define, implement and continually enhance best risk management practices. These practices must address how the quality of information from a client affects margin, collateral, and other credit terms and other aspects of counterparty risk management.
- Lenders to private pools of capital [should] frequently measure their exposures, [should] [take] into account collateral to mitigate both current and potential future exposures. Credit exposures, in addition to being measured frequently, should also be subject to rigorous stress testing, not just at the level of an individual counterparty, but also aggregated across counterparties and should consider scenarios of adverse liquidity conditions. The liquidity of the counterparty's positions should be a factor in exposure measurement, since concentrated or illiquid positions can lead to crowded trades and unexpected exposures in the event of a counterparty default or market volatility.
- Information should be disclosed frequently enough and with sufficient detail that investors, counterparties and creditors stay informed of strategies and the amount of risk being taken. On a regular basis, investors, counterparties and creditors should seek to obtain from the manager both quantitative data and qualitative information on the pool's net asset value, performance, market and credit risk exposure, and liquidity.
- Regarding post-trade obligations, managers, counterparties and creditors should also continue to strengthen and enhance their processing, clearing, and settlement arrangements, particularly for OTC derivatives. This will limit the contagion effect of weak post-trade processes if there is failing counterparty or highly leveraged institution.[11]

The European Central Bank has also, in June 2006, issued a warning on the systemic risks posed by hedge funds (ECB Financial Stability Review). The EDHEC Risk and Asset Management Research Centre has also published papers on this issue, questioning some of the fears of overcapacity in, and systemic risk posed by, the hedge fund industry.

How a Hedge Fund Can Pose Systemic Threats

Concern about systemic risks has arisen in several contexts. There is, at times, a self-congratulatory mood that no hedge fund failure has resulted in systemic risk.

There are common features among these events:

1. Declining fundamentals;
2. Excess leverage; and
3. Nervous investors combined with illiquid investments.

Typical methods for assessing risk rely on measuring volatility; the choppier the returns are, the riskier the investments. But because illiquid assets do not trade regularly, marking to market—or using recent sales prices to determine the assets' value—may not be possible. In these cases, a fund manager may instead use a mathematical model to value an asset, a practice called marking to model. Such models tend to smooth returns, making an asset look much less risky. "Using broker-dealer quotes for illiquid assets can also [reduce the appearance of] volatility because they are often based on average of bid and offer prices rather than actual sales prices."[12]

First, when the market suffers fundamental or unexplained losses (as in emerging market loans, commodities, or subprime mortgages), the funds' expected bets have disrupted the funds. Second, the funds have excess leverage in various forms, such as (1) by borrowing directly from financial institutions, (2) by borrowing in the course of transactions (buying securities on margin), (3) by borrowing through short sales (*e.g.*, committing to selling specified assets on a future date that the funds do not own in the hopes that the fund will be able to purchase the assets at a lower price than the price sold at the time the fund is committed to transfer the assets), (4) by investing in secured assets (like CDOs) when different investors take different degrees of losses because some investors invest in residuals that promise higher returns and other investors take tranches with safer lower yields, which also trade less frequently making them hard to sell.

There are similarities between the risks that characterize the failure of Amaranth and the two funds managed by Bear Stearns. For example, a drop in value of the holdings of two Bear Stearns funds investing in collateralized debt obligations (CDOs) as they are now could have widespread market repercussions. Many other investors have brought similar subprime-backed securities. Since CDOs trade infrequently, their market values are hard to assess; hedge funds often mark them on their books according to computer-driven models that are prone to missing changes in market sentiments. A fire sale of the Bear Stearns fund assets could have forced other investors to mark down the values of their portfolios.

Actual Systemic Threats Posed by Hedge Funds

Of course, funds have failed or have performed so poorly that they have been closed to prevent redemptions or bailed out to maintain liquidity. Currently, in the fund failures triggered by concerns about subprime mortgages, there is an actual government bailout (althought not directly to hedge) by the European Central Bank and the Federal Reserve to make available an aggregate $112 million more than usual to ensure liquidity. In the context of the LTCM fund, the Federal Reserve intervened to address the risks potentially posed by LTCM in 1998. Askin Capital Management (in 1994) sustained huge losses on infrequently traded mortgage-backed securities. The Amaranth commodity fund lost about $6 billion when it could not easily unwind esoteric trades that went against it. UBS terminated its hedge fund run by Dillon Read Capital Management in May 2007 when bad trades and subprime mortgage loans investments led to a $12.4 million loss in June and July 2007. Two hedge funds run by Bear Stearns nearly imploded as a result of a downturn in parts of the subprime mortgage market and the funds' bets on collateralized debt obligations. In June 2007, Queen's Walk Investment Limited, a London publicly traded fund manager, lost 50 percent of its US mortgage portfolio and 25 percent of UK mortgage bond holdings.[13] The casualties keep building, including: The Australian Fortress fund, Axa managed funds, two BNP Paribas Funds (which have been closed down in August 2007), the Soigood Funds, and funds managed by NIBC.

In September 2006, Amaranth Advisors, a hedge fund with more than $9 billion under management, folded after losing approximately $6 billion in one week on heavily leveraged investments in natural gas futures. Amaranth made exceedingly high profits in 2005 when it had bet heavily on natural gas futures prior to the price spike partially precipitated by Hurricane Katrina. However, its futures trading strategy often involved using highly leveraged positions to acquire many energy contracts, particularly natural gas, propping up

the prices in the market and increasingly exposing the fund to the risk of incrementally smaller variances in the spread in futures contracts and the risks posed by changes in market price. Several other factors, including the short history of commodities futures trading models, the lower margin money required to trade in commodities markets, a milder hurricane season in 2006 than expected, a glut of surplus natural gas, and an abundance of easily available credit ultimately resulted in Amaranth's energy traders' miscalculation regarding the monthly spread in futures contracts and contributed to large losses and the fund's finally transferring its energy portfolio to Citadel Investment and JPMorgan Chase. Among significant investors in Amaranth had been funds of funds offered by Morgan Stanley and Goldman Sachs.

Amazingly, despite the CPRMG guidelines, the Amaranth fund imploded. One wonders when the risk management of Amaranth by its counterparties existed or how it worked.

There have been more ironic twists, as the market becomes more complicated and intertwined, twists to which Assistant Secretary Ryan alluded. For example, the *Financial Times* has noted the following:[14]

- Hedge funds are arguing against bank decisions to help "delinquent US mortgage borrowers remain in their homes, in a move that puts some of the country's richest people in the position of arguing that some of its less well-off could be getting unfair breaks."[15]
- Hedge funds have charged that banks that both sell the derivatives contracts and handle mortgage payments could be involved in a form of market manipulation, since banks are making concessions on the underlying mortgages, such as lowering the interest rate or extending the life of the loan, so that the Bank may avoid paying derivatives contracts that pay off in cases of default. "These changes do not automatically trigger write-downs on the mortgage bonds, which would result in a payment to purchasers of the credit-insurance derivatives."[16]
- More than 25 funds have asked the International Swaps and Derivatives Association, the derivatives industry body, to act on their concerns.
- Hedge-fund managers also accuse Bear Stearns of attempting to manipulate the market for securities backed by subprime loans by purchasing potentially delinquent mortgages, in accordance with Bear Stearns' contractual rights.
- Bear Stearns (not its funds) has sold a large amount of credit default swaps, or CDSs, instruments that act as insurance policies on various kinds of bonds, including those backed by subprime mortgages. Many hedge funds have bought these swaps, expecting a downturn in subprime home loans. Bear Stearns has taken the opposite position, selling swaps and making a bet that conditions will improve or will not further deteriorate as some people think.
- Many hedge funds, in February 2007, had been shorting a derivative index (ABX) that is tied to a basket of subprime bonds with weak credit ratings. Since the ABX index has improved, hedge funds that have taken these short positions have complained that Bear Stearns has propped up mortgages-backed securities by purchasing individual mortgages that were rapidly losing value to avoid paying billions in swap payments. Bear Stearns, however, claims that its mortgage-servicing decisions are not driven by any activity or outstanding positions in the CDS market.

In May, Bear Stearns stopped redemptions by investors attempting to pull out of the two funds. Almost simultaneously, banks and brokerage firms that had lent money to the funds demanded more collateral. In late June, Bear Stearns said that it would lend $1.6 billion to one of the funds. Bear Stearns has said that it would wind down the funds and that the funds' losses were due to "unprecedented" declines in the valuations of a highly rated (AA and AAA) securities. This raises issues about how the funds and other investors valued these securities and whether lenders and investors knew how their funds have been invested.[17]

Later, Bear Stearns lenders seized most of the collateral of the funds that it lent money to following the funds' failure to meet a recent margin call. Bear Stearns has said that it does not expect a material change in its parent company's financial exposure. The credit-derivatives market and the stock market seem to disagree with the Bear Stearns view of the impact on Bear Stearns, since the cost of protection against default by Bear Stearns (and other investment banks like Lehman, Goldman, Merrill) has risen and the stock price has fallen.[18]

The problems and risks in the market for mortgages and derivatives continue to reverberate, for example, as synthetic or cloned hedge funds, which pick a fund or group of funds, pick a portfolio of stocks that would have yielded the same returns as the selected fund or funds over a period of a year, and that portfolio becomes the investment portfolio for the next month. Obviously, these products do not take into account rapidly changing hedge fund positions.[19]

The wonderful aspect of the current system is that financial risk is dispersed. However, that makes it harder to quantify the amount of risk. Subprime loans and covenant lite loans proliferated, in part, because they have been packaged and sold to investors, and the originators could transfer the risk to such investors.

Financial Firms' Activities with Hedge Funds

Financial firms face hedge funds as intermediaries or counterparties, or even establish and manage their own hedge funds, and provide many services and products that expose them to varying degrees of risk in the following areas:

- Prime brokerage (securities lending, trading, clearing and settlement);
- Loans and other forms of credit extension and credit enhancement;
- Structured products;
- Proprietary investment in hedge funds;
- Offering external funds and in-house managed hedge funds as investment products;[20] and
- Custodial and cash management services.[21]

Prime Brokerage

According to an SEC no-action letter, "prime brokerage is a system developed by full-service firms to facilitate the clearance and settlement of securities trades for substantial retail and institutional investors who are active market participants." Prime brokerage involves three distinct parties: the prime broker, the executing broker, and the customer. The prime broker is a registered broker-dealer that clears and finances the customer trades executed by one or more other registered broker-dealers (executing broker) at the behest of the customer placed with the executing brokers. The prime broker agrees with the executing broker to clear and carry each trade placed by the customer when the customer directs delivery of money or securities to be made to or by the prime broker.

The customer maintains its funds and securities in an account with the prime broker. Orders placed with the executing broker are effected through an account with the executing broker in the name of the prime broker for the benefit of the customer. On the day that a customer places a trade order (trade date), the executing broker buys or sells securities in accordance with the customer's instructions. On the trade date, the customer notifies the prime broker of the trade performed by the executing broker. The transaction is recorded in the customer's cash or margin account with the prime broker. At the same time, the prime broker records the transaction in a fail-to-receive/deliver account with the executing broker.

The prime broker issues a confirmation or notification to the customer and computes all applicable credit and Regulation T amounts. The executing broker confirms the transaction with the prime broker through the Depository Trust Company's Institutional Delivery System. The prime broker then will affirm the trade if its information matches successfully with the information received from the executing broker. The trade may then be submitted to the National Securities Clearing Corporation for clearance and settlement following normal settlement procedures. The prime broker then settles with the customer in the normal way.

The prime broker issues a statement of account to its customer at least on a monthly basis. The statement includes all security transactions during that period and the resultant customer security positions and money balances.

This arrangement is advantageous to prime brokerage customers because the prime broker acts as a clearing facility and accountant for all of the customer's security transactions wherever executed, as well as a central custodian for the customer's security and funds."[22]

Thus, prime brokerage is a line of business that, in its most basic form, involves the execution, clearance, and settlement of transactions between parties, typically hedge funds, that are actively trading in the market.[23] Prime brokerage includes finding and lending stock

to allow hedge funds to sell short, and structure and execute derivatives.

The following core services are typically bundled into the prime brokerage package:

- Global custody (including clearing, custody, and asset servicing).
- Securities lending.
- Financing (to facilitate leverage of client assets).
- Customized technology (provide hedge fund managers with portfolio reporting needed to effectively manage money).
- Operational support (prime brokers act as a hedge fund's primary operations contact with all other broker-dealers).
- Capital introduction: A process whereby the prime broker attempts to introduce its hedge fund clients to qualified hedge fund investors who have an interest in exploring new opportunities to make hedge fund investments.
- Office space leasing and servicing: Certain prime brokers lease commercial real estate and then sublease blocks of space to hedge fund tenants. These prime brokers typically provide a suite of on-site services for clients who use their space.
- Risk management advisory services: The provision of risk analytic technology, sometimes supplemented by consulting by senior risk professionals.
- Consulting services: A range of consulting/advisory services, typically provided to start-up hedge funds, and focused on issues associated with regulatory establishment requirements in the jurisdiction where the hedge fund manager will be resident, as well as in the jurisdiction(s) where the fund itself will be domiciled.

Prime brokers generally derive fees from the following sources: spreads on financing (including stock loan); trading commissions and fees for the settlement of transactions done away from the prime broker; transaction processing fees and brokerage commissions; interest on margin and credit balances; and dealers' spreads gained in principal transactions

The difference in roles when an entity acts as both a broker/agent and a counterparty or lender gives rise to multiple risks of financial firms.

Notes

1. *See, e.g.*, Moody's rating of Sorin fund.
2. Financial Stability Forum (FSF), May 19, 2007, Hedge Fund Report.
3. The term "hedge fund" originated with a fund founded in 1949 by A.W. Jones, which shorted some stocks and was long on other stocks and in part was therefore hedged. Some say that John Maynard Keynes was one of the first to use hedge fund strategy.
4. The PWG (the Treasury Secretary, chairmen of the Federal Reserve Board, the SECS, and the Commodities Futures Trading Commission (CFTC)) issued on Feb. 22, 2007, a document entitled "Guidance on Issues Common to Private Pools of Capital" (PWG report).
5. CPRMG (March 9, 2005).
6. Remarks by Chairman Alan Greenspan to the Federal Reserve Bank of Chicago (May 5, 2005) and Keynote Address of President Timothy F. Geither of the Federal Reserve Board (Nov. 17, 2004).
7. Credit Default Swaps holders were betting on a decrease in the debt ratings of General Motors at the same time that Carl Icahn made a surprise bid for the company, a bid that had the opposite impact on the bonds' ratings.
8. The FSF 2007 Report, p.12.
9. Treasury Assistant Secretary for Financial Markets, Anthony W. Ryan, remarks before the Managed Funds Association Conference, 6/11/07.
10. *Id*.
11. *Id*.
12. *Wall St. J.*, June 27, 2007.
13. Queen's Walk had invested in first loss or residuals, which generally produce strong returns, unless they take the first hit. Queen's Walk has sold three US subprime mortgage pools. *Wall St. J.,* June 27, 2007.
14. "Hedge Funds Hit at Subprime Aid for Homeowners," Financial Times, June 1, 2007.
15. *Id*.
16. *Id*.
17. "Bear Stearns Says Battered Hedge Funds are Worth Little," *NY Times*, July 18, 2007, C2.
18. Aparajita Juha-Bubna, "Wall Street's Double Trouble," *Wall St. J.,* C5.
19. "The Hedge Fund Clones," *Wall St. J.*, July 21-22, 2007, C1.
20. CSFB Review (Mar. 9, 2005) and Statement of Julie L. Williams (Oct. 1998).
21. Statement of Julie L. Williams (Oct. 1998).
22. Jan. 25, 1994, SEC No-Action Letter, LEXIS 466.
23. *See* Report of the Counterparty Risk Management Policy Group II (July 27, 2005).