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FSA Hedge Fund Surveys Conclusions Published

The UK Financial Services Authority (FSA) recently published a report entitled "Assessing possible sources of systemic risk from hedge funds." It sets out the FSA's key findings and conclusions from two surveys it conducted in April 2010—the Hedge Funds as Counterparties Survey (HFACS) and the Hedge Fund Survey (HFS). The FSA intends to continue conducting these surveys every six months to help monitor trends in hedge funds. (The results of the October 2009 surveys, published in February 2010, were reported in the February 26 edition of *Corporate and Financial Weekly Digest*).

The HFACS has been conducted every six months since 2005. It asks some of the largest FSA-authorized banks with exposures to hedge funds about their credit counterparty risks. The HFS was introduced in October 2009 to complement the HFACS. It surveys the 50 largest FSA-authorized investment managers, on this occasion with a combined total of $345 billion in hedge fund assets under management. The survey asks questions about the assets the firms managed and the larger funds for which they undertake management activities.

The report's conclusions, which were in line with the FSA's expectations of an increase in risk appetite and improved market conditions since the previous survey in October 2009, were:

- hedge funds are using more leverage;
- hedge funds are borrowing more through repurchase agreements and less through prime brokerage;
- with the exception of corporate bonds, positions held by the surveyed hedge funds did not comprise a particularly large proportion of any total asset class;
- measures such as performance, open positions, concentration of positions, overall exposure of funds by LMV vs. SMV and prime brokerage cash balances to net equity ratio suggest hedge funds have a higher risk appetite at April 2010 compared to six months earlier; and
- hedge funds appear to have further diversified their credit exposures to bank counterparties.

The FSA reported that there was no material change in the systemic risk to financial stability as against the survey six months previously. That survey had concluded: "The HFACS data suggests that on October 31, 2009, major hedge funds did not pose a potentially destabilizing credit counterparty risk across the surveyed banks. HFS data shows a relatively low level of 'leverage' under our various measures and suggests a contained level of risk from hedge funds at that time."

To read the report in full, click here.

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