Fund Chiefs Back Oversight; Managers Tell Lawmakers They Would Give Data to Regulators

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Five of the world's wealthiest billionaire hedge-fund managers said yesterday that they would support greater oversight of their secretive $2 trillion industry, as momentum grows in Congress for stricter control of an essentially unregulated corner of the financial world.

"The systemic risks have grown larger, yet federal regulators have virtually no oversight of your industry," said Rep. Henry A. Waxman (D-Calif.), chairman of the House Oversight and Government Reform Committee, which called the managers to testify. "And that's a potentially dangerous situation."

The hearing came as Sen. Charles E. Grassley (R-Iowa), ranking member on the Finance Committee, announced he would reintroduce legislation to require hedge funds to register with the Securities and Exchange Commission. No agency now has jurisdiction over the funds.

The five managers -- who were paid an average of more than $1 billion last year, according to the committee -- told the panel that hedge funds were not responsible for the current crisis, but said they would be willing to support transparency in the industry. Several said they believe that the funds create risk in the financial system.

"The entire regulatory framework needs to be reconsidered, and hedge funds need to be regulated within that framework," said investor George Soros, a well-known supporter of liberal causes and chairman of Soros Fund Management. "But we must beware of going overboard with regulation."

Hedge funds, sometimes called a shadow banking system, are private investment funds that do not advertise to the public and cater to wealthy individuals and institutional investors. They are not required to register with the federal government, which lacks the regulatory authority to obtain information to help measure their risk to the economy.

Lawmakers also criticized the managers for taking advantage of a tax loophole that lets much of the money they earn be taxed at a rate of 15 percent -- far lower than the 35 percent tax rate for most wealthy Americans and even lower than the 25 percent rate for working-class Americans who earn $35,000 a year.

"So Joe the Plumber is being taxed at a higher rate?" said Rep. Elijah E. Cummings (D-Md.). "Does this seem fair to you?"

The House has voted to close the loophole twice before, but the measure died in the Senate. Most of the fund managers said they would support legislation that would close the loophole, as long as it applied to other industries that benefit from it.

In addition to Soros, the managers that testified were John Alfred Paulson, president of Paulson & Co.; James Simons, president of Renaissance Technologies; Philip A. Falcone, senior managing partner of Harbinger Capital Partners; and Kenneth C. Griffin, chief executive and president of Citadel Investment Group.

The managers gave the committee detailed information on their business -- including executive compensation and internal e-mails -- but the panel has so far chosen not to release it.

The pressure for greater regulation mounted as the hedge-fund world exploded from a cottage industry of 200 funds worth $1.5 billion in 1969 to 9,000 funds worth $2 trillion today. The calls for heightened scrutiny increased when Long-Term Capital Management, a Connecticut-based fund, lost half of its capital and the Federal Reserve in 1998 had to arrange a $3.6 billion rescue package to prevent its collapse.

The SEC created a rule in 2004 that required the managers to register with the agency, make some information public and allow the agency to inspect its books. But the program was struck down by a federal court two years later and the SEC did not appeal the ruling. The legislation Grassley intends to introduce would make it clear that the SEC has the authority to regulate the funds.

Speaking before the panel, the fund managers said they would be willing to provide data to a regulator who could then transfer it to the Federal Reserve, which could use the information to monitor systemic risk to the economy. But the managers said they would vigorously oppose the public release of details about their investment strategies.

"To ask us to disclose our positions to the open market would parallel asking Coca-Cola to disclose their secret formula to the world," Griffin said.

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Return to Top