PUBLIC COMMENT MATRIX

FRAMEWORK FOR THE REGULATION OF HEDGE FUNDS IN SOUTH AFRICA (PUBLISHED 13 SEPTEMBER 2012)

LIST OF COMMENTATORS:

Actuarial Society of South Africa	Asisa
Aylett & Co Fund Managers	Badger Capital
Banking Association South Africa	Black Rock
BVG	Capricorn Fund Partners
ENS	Eskom
FirstRand Group	IDS Fund Services
JSE Securities Exchange	Kanaan Trust
Novare Investments	Oak Advisory
Old Mutual Investments	PricewaterhouseCoopers Inc
Rand Merchant Bank	Steyn Capital Management
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Key: **RF – Retail Hedge Fund**

QIHF – Qualified Investor Hedge Fund

PB – Prime Broker

FA – Fund Administrator

CISCA – Collective Investment Scheme Act, 2002

FAIS – Financial Advisory and Intermediary Services Act, 2002

Manco – Management Company or Collective Investment Scheme Manager

Relevant paragraph	COMMENT	JOINT WORK GROUP COMMENT ON EVALUATION OF THE COMMENT
1.1. The purpose of this document is to provide a framework on the proposed regulation of hedge funds. The proposal is to regulate and supervise certain hedge fund structures under the existing Collective Investment Scheme Control Act, 2002 ("the Act") with the creation of a new and separate category for hedge funds as a collective investment scheme. This can be done through the insertion of a separate chapter in the Act dealing with hedge funds. This will, therefore, require an amendment of the Act.	**1.1** • It is stated that the proposal is to regulate and supervise "certain hedge fund structures", however neither this portion of the document nor latter sections definitively deal with which structures will be included, and whether or not inclusion under a CISCA framework will be optional or compulsory, particularly with regard to existing Hedge Fund structures managed by FSP Category IIA fund managers. • The rationale as to why Hedge Funds are being proposed to be included in the Collective Investment Scheme Control Act (CISCA) is required. • **Footnote No.2** relating to Paragraph 2 (Policy / Regulatory	• The intention is to regulate all hedge funds including those that are managed by FSP IIA investment managers. The Minister is going to declare hedge fund business as the business of a collective investment scheme. Thereafter **ALL** managers of hedge funds, both retail and qualified, will be required to register in terms of the applicable regulations. • In line with SA G20 commitments and the international approach to hedge funds it has been determined by National Treasury that hedge funds should be regulated. Hedge funds are viewed as a type of pooled investment, therefore the decision was made that they be regulated in accordance with the existing collective investments legislation.

	Objectives), does however state that “The term hedge fund manager in the context of this document refers to a manager of a collective investment scheme in hedge funds and should not be confused with the category IIA hedge fund manager financial services provider.” The impression gained from the above mentioned footnote is that existing Hedge Funds, the majority of which are managed by Category IIA fund managers are not included in the context of the proposed framework, although it is not clear if this is an appropriate deduction.	• Investment managers that manage hedge funds will not be regulated in terms of the proposed hedge fund regulations, however the funds that they manage will be the subject of the regulations. Investment managers will still be regulated under FAIS and the CAT IIA licence requirements.
	• The proposed move to regulation under the Collective Investment Schemes Control Act raises concerns. Will regulations make allowance for smaller funds to have unrestricted access to MANCO’s? Once again, this point has the potential to disqualify a number of smaller funds. This will reduce diversification and choice that investors have and be anti-competitive.	• Existing CIS managers will be able to establish hedge fund schemes, qualified investor hedge funds (restricted funds) will be able to invest in retail funds and most of the hedge fund managers (FSP IIA) currently managing hedge fund portfolios will fall within the QIHF category and will not need a MANCO. Only those managers looking to operate retail hedge funds will require a MANCO, which could either be established or smaller funds can enter into third party portfolio arrangements (formerly “white labelling”) with licensed managers. We therefore do not think that the proposed regulation will have an undue impact on smaller funds.
	• There is general support for the overarching goal to allow for the regulation of Hedge Funds at a product level, under the umbrella of an extended and amended CISCA. There should therefore be alignment with current CISCA practices, adapted for the local hedge fund industry realities. • A specific uncertainty is the scope and ambit of the proposed product regulation - the use of the wording	Noted and agreed Certain hedge fund structures refers to the retail hedge funds which will be subject to more stringent regulation while the qualified fund

	"certain hedge fund structures" seems to imply that a further category of hedge funds is possible outside of product regulation. This raises the question of what defines a "regulated fund". In section 1 of the current CISCA both "collective investment schemes" as well as "members of the public" are defined. The question remains how this will be applied within a revised CISCA which will incorporate hedge funds. Clarification is needed on the perimeter and capture of the envisaged framework, and the definition and treatment of "private arrangements".	will be lightly regulated with more focus on disclosure and reporting. Both structures will be regulated under CISCA. The intention of the declaration is to regulate all hedge funds. The extent to which private arrangements will be captured under the new hedge funds regulations is still under discussion.
1.3. Prior to amendment of the Act, as an interim measure the hedge fund structure will be declared a scheme in accordance with section 63 of the Act; through the promulgation of subordinate legislation. Section 63 of the Act empowers the Minister to declare a specific type of business to be a collective investment scheme to which the Act or any part of the Act applies. The Minister will be requested to issue such a declaration as an interim measure until an amendment to the Act can be effected. Interim measures are proposed in order for South Africa to meet its G20 commitments.	• Implication on the Collective Investment Schemes Control Act of declaring all hedge funds as Collective Investment Schemes needs to be clarified, specifically in relation to the following: ▪ Implications of general CISCA provisions during the interim period until the specific section for CISs in Hedge Funds is released ▪ Transitional provisions and deadlines to align mandates etc. with requirements.	The business of hedge funds will be declared as collective investment scheme. All hedge funds will thereafter be required to register in terms of that declaration. Until the declaration, CISCA will not apply to hedge funds and even then a transitional period will be provided for.
	• DECLARATION The legal and administrative process during a transition period, as well as the level and extent of work done before the commencement of any transition is of obvious and key concern to most industry participants. It is in the interest of all parties to ensure a smooth and equitable transition,	We are mindful of the concern and these processes will be taken cognizance of in determining and providing for a transitional period.

	within an acceptable timeframe. However, there are many aspects which warrant substantial further discussion, amongst others: 1. The declaration of a scheme, and the impact on current structures, which are encased in other legal provisions and law. This includes en commandite partnerships (50%), debenture structures, variable rated as well as zero rated (35%), trusts (10%) and other structures (5%). The percentages reflected serve as a broad indicator of the current industry practice. 2. Communication to stakeholders, especially investors, prior to such an event. 3. Possible special dispensation to ensure the orderly movement of both assets and liabilities (investors) and the protection of the rights of investors. 4. The various milestones and anticipated timeframe leading up to a general declaration under Section 63, as well as the milestones after such declaration to achieve full compliance and requirements in the "declared but not compliant" stage. 5. The possible application of PART XI (Conversion of CIS) of current CISCA. • We therefore request further engagement with NT and FSB to discuss these matters, as this was not specifically addressed in the previous presentation and submission.	Noted and will be addressed. CISCA permits a scheme to be established in *"whatever form"* and this will apply to qualified investor hedge funds. The aim is to avoid any disruptions to the existing structures, but to still regulate them in whatever form. Retail hedge funds will be required to adopt the CIS Manco structure. The importance from a regulatory perspective is to provide adequate investor protection. This will be prescribed in the regulations. This is linked to the aspect of taxation implications and is under consideration by National Treasury and SARS. There will be a transitional period during which time these issues will be resolved, prior to application of the law. The applicable provisions for conversion of schemes will be considered. Registering another scheme is also an option. The intention is to ensure continuous engagement with stakeholders as necessary and some engagements have already taken place.
1	• G20 COMMITMENT According to a report accessed on the Financial Stability Board's website titled "Progress in the Implementation of G20/ FSB recommendations – June 2012" for South Africa, the item dealing with "regulation' has been deemed as	As indicated above, the declaration will not be automatic, managers will have to apply for registration and approval. The transitional period will address these concerns.

	completed as hedge fund managers have been required to register with the FSB under FAIS since 2007. The outstanding item is the review of "reporting and disclosure requirements for hedge fund managers" in line with IOSCO recommendations. The work groups concurred with this view, and proposed the Systemic Risk and required reporting is dealt with under FAIS. The specific data elements must be further considered within the larger context the industry operates in. The same report also refers to the management of counter-party risk as well as the management of exposures to leverage counterparties, with specific mention to banking institutions and legislation, as well as pension funds and Regulation 28. The statement is made that the hedge fund industry is currently small "and so there are no systemic risk issues".	Noted. The reporting and disclosure requirements will be provided for in regulations. The decision has been made to regulate hedge funds in this manner and accordingly the respective systemic risk reporting will follow the regulations. The reporting will enable monitoring of potential and actual systemic risk.
1.4. The intention is not to regulate hedge fund financial service providers but to regulate hedge funds as a special collective investment scheme.	It is stated that the intention of the proposed framework is to regulate the hedge funds, not hedge fund financial service providers ("FSP"), however 4.2 deals specifically with "The manager" in terms of their legal structure, reserving and capital requirements etc. as envisaged under the CISCA framework. This theme is also perpetuated through other sections, including Section 5, dealing with registration of managers under CISCA. Perceived implication is the creation of a new category of "manager" (a hedge fund FSP vs. the collective investment scheme manager). In this respect, it is essential to then look at the definition of "hedge fund" in terms of the role / activity of the manager that needs to be regulated.	An important distinction is that the hedge investment manager will be regulated under FAIS, but the actual fund (CIS HF Scheme) will be regulated under the regulations. A HF manager refers in this document to the CIS HF manager. The regulation will create a new type of collective investment scheme but not a new structure of a manager, i.e. a manager of a hedge fund scheme. The intention of the regulation is to regulate hedge funds but not their managers although CISCA requires a hedge fund CIS manager who establishes the fund to register? and these managers will be required to comply with the new regulations.
	Consideration should be given as to whether there should be	Managers may market RFs. further determinations regarding

	any restriction on who can market Retail Hedge Funds to the general public.	intermediaries are made in terms of the FAIS Act, 2002.
This may facilitate a separate tax treatment. Tax concerns were previously an obstacle to getting agreement on the regulation of hedge funds. Guidance should be given by National Treasury.	**Footnote 1** Refers to the possibility that inclusion under CISCA may facilitate a separate tax treatment, with guidance to be provided by National Treasury. We request further detail in this regard.	The Taxation Laws Amendment Bill 2013 (TLAB) has already made provision for this, as was undertaken by National Treasury and SARS.
	Given that it is proposed that the hedge funds (both retail and restricted be included in the CISCA legislation as collective investment schemes, we are strongly of the view that the current treatment of tax for collective investment schemes in securities (CISS) should be extended to hedge funds. The current tax provisions relating to CISS are aimed at tax transparent treatment of CISS, with flow-through of tax implications to holders of participatory interests in CISS. The most notable provisions in the Income Tax Act in this regard are: • Section 25BA, which provides for receipts of accruals of a CISs not being taxed in the hands of the CISs and retaining its nature in the hands of the investors, provided they are distributed within 12 months; • Paragraph (e) of the definition of 'regulated intermediary' in section 64D, in terms of which CISS constitute regulated intermediaries for purpose of Dividends Tax; and • Paragraph 61 of the eighth schedule, which provides that participatory interests in CISS are only subject to CGT upon disposal of the interest. • The view of the Work Group is that the tax treatment is normalised in line with current CISCA arrangements and practices	Done, see above. Done, please see above.

2.1. Regulatory objectives include: **2.1.1. greater investor protection;** **2.1.2. prevention of systemic risk;** **2.1.3. the promotion of market integrity; and** **2.1.4. transparency.**	**2.1 Regulatory Objectives;** • Transparency in particular is a growing area for hedge funds globally, and will continue to do so – especially as hedge funds are getting more attention from institutional investors, and that hedge funds are starting to 'play' more and more closely to traditional investments like mutual funds.	Agreed.
	With reference to section 1.1 above, and in regard to Footnote No.2, the understanding of applicability relative to existing funds and Category IIA fund managers is unclear.	Cat IIA managers will continue to be regulated under the FAIS Act.
Restricted Hedge Funds - These are funds which do not solicit the sale of their participatory interests from the public and are limited in their membership to private arrangements amongst qualified investors. These funds will not be subject to strict regulation. They will be required to register as restricted funds in accordance with the registration requirements determined by the Registrar. They will have to disclose, amongst others, the number of clients, the names of their clients and details of their counterparties. In addition the restricted fund will lodge annual returns to the Registrar for the purpose of assessing levels of leverage.	**Restricted Hedge Funds:** Section 2 of the proposed framework specifies two categories of hedge funds, namely Restricted Hedge Funds and Retail Hedge Funds. We suggest that more detail needs to be provided as to what the requirements are for Restricted Hedge Funds relative to Retail Hedge Funds. In addition, we do not think it is adequate (as suggested in 2.3) that Restricted Hedge Funds only submit returns on an annual basis. This is not sufficient to assess systemic risk. We suggest that all funds should submit returns on a monthly basis, or at a minimum, quarterly.	Restricted funds are now called Qualified Investor Hedge Funds. Detail will be provided for in the regulations as to the requirements for QIHF. It is proposed that quarterly and annual returns be submitted by both types of funds. Monthly reporting will be considered after consultation with industry, but will be further clarified in the regulations.
	The disclosure of counterparties for this category or type of funds is of immense importance (and ties up with the objectives of transparency and especially systemic risk).	Agreed. All hedge funds will be required to disclose their counterparties to the supervisor/Registrar. Noted – will be provided for in the regulations.

	The framework states that annual returns should be lodged with the Registrar, but for continual and proactive assessing of systemic risk these funds will have to lodge their return at least monthly.	Noted, please see above.
	The framework states that levels of leverage should be lodged with the registrar – it is recommended that this is lodged on a monthly basis.	Noted, please see above.
	Leverage should include all forms of leverage; short selling and borrowing. The proposed framework defines leverage solely as borrowed funds. I thus recommend that the framework explicitly includes short selling.	Agreed – see par 3.2, short selling is allowed and will be taken into account when funds look at their gross exposure and leveraged amount.
	The name "Restricted Hedge Fund" may be misleading because, in contrast to the Retail Hedge Fund, the underlying investments are "unrestricted". In addition there does not appear to be the intention to limit the level of leverage employed. Given that the other category is named "Retail Hedge Funds", it may be more appropriate to adopt the term "Institutional Hedge Fund" instead of "Restricted Hedge Fund". We agree with the proposal that "Institutional Hedge Funds" should be required to have a minimum investment limit of at least R1 million, or higher at the manager's discretion.	Noted and agreed – definition of restricted funds amended to indicate clearly that they are restricted to qualified investors. We have in addition decided to change the name to Qualified Investor Hedge Funds.
	In the explanation as to what constitutes or defines a Restricted Hedge Fund, reference is made to "qualified investors". Notwithstanding 3.7, this term is a critical concept in terms of distinguishing this proposed class of Hedge Fund from the Retail Hedge Fund covered in 2.4, and it does not appear to be adequately defined. With reference to 2.4, it is not clear whether or not an "institutional investor" may be a client of / investor in a Restricted Hedge Fund.	This will depend on the nature of the institutional investor, this means it needs to conform to the definition and criteria of a qualified investor.
	By far the most important point that needs to be clarified is	The QIHF is limited to qualified investors. We have considered this and

	the confirmation that the second type of hedge fund, namely “restricted hedge funds”, will indeed be a product category / scheme under the Collective Investment Schemes Control Act, 2002 (CISCA). We have encountered different interpretations of the scope of the definition for a “restricted hedge fund”. The framework defines “restricted hedge funds” as “…limited in their membership to private arrangements amongst qualified investors”. However this can be interpreted as the type of investors that CISCA refers to as “…persons confined to a restricted circle of individuals with a common interest who receive the invitation in circumstances which can properly be regarded as a domestic or private business venture between those persons and the person issuing the invitation” (accents added) – which falls outside of the ambit of CISCA. Although we do not believe that, as it currently stands, it is an intended consequence for this hedge fund type (currently referred to as “restricted hedge fund”) to fall outside of CISCA, it is kindly requested that this point is stated with sufficient clarity so as to avoid potentially far-reaching (and unintended) effects and impact on the industry.	have removed references to private arrangements. Investment in hedge funds is therefore not restricted to private arrangements and an investor will only be required to meet the requirements of a qualified investor in order to invest in a qualified hedge fund. Members of the public may invest in retail hedge funds.
2.3, 2.4, 5.1, 5.2 :	Given our general comments raised above, we propose that a further class be inserted to ensure that smaller, entrepreneurial fund managers are not excluded from the industry due to the extensive barriers to entry. We propose a "start-up funds" category. These are funds which: • will not be required to procure the registration of collective investment scheme managers as per section 5.2, but the managers will have to register with the Financial Services Board in order to obtain a category IIA-licence • have assets under management of less than a relatively small amount (e.g. R50 million) to enable the smaller	Most hedge funds operating in the market today should be able to meet the requirements of a QIHF. Hedge funds establishing retail hedge funds will be subject to the higher level of regulations. Smaller hedge funds looking to establish a retail hedge fund which requires the establishment of a Manco may be accommodated in terms of the notice on third party named portfolios. The QIHF will not be required to establish a Manco provided that there is a governing body (e.g. Board of Directors)..

	manager to first ensure that their fund is big enough to be financially viable; • do not solicit funds from the public; • are limited to no more than a small number of investors (e.g. 50) making investments of at least R100 000; • have a significant investment (e.g. 10%) from the fund manager himself; • are not subject to strict regulation; and • are not required (due to the extensive cost increase) to provide daily pricing as per section 6.3.2 and 14 day liquidity as per section 6.4.1, but only monthly pricing and liquidity.	
	As a single "start-up fund" will be very small compared to the industry as a whole, the potential consequences of fewer regulations are far outweighed by the advantages of assisting the industry to grow. Alternatively, we propose that existing smaller funds (e.g. assets under management of less than R50 million) be given either: • a transitional period of 3 years after the enactment of the regulations to comply; or • a viable CISCA-manager option be sought to ensure that these funds are not forced to close.	There are adequate provisions under CISCA for smaller funds – third party named portfolios e.g. incubator funds (former "white labels"). It is not envisaged that the hedge funds regulations will prescribe the asset size of the hedge fund for eligibility. An appropriate balance will be aimed for between the extent of the regulations and the nature of the funds.
	• The establishment of a 2 tiered approach under CISCA is supported. Retail Funds – subjected to prudential regulation, with detailed restrictions regarding underlying assets, leverage, exposure, and liquidity. Restrictions to be based on an expanded BN 80 with cognisance of the UCITS rules (EU directive 2007/16/EC).	Noted. The specific restrictions or limitations will be proposed in the regulations.
	• Required minimum investment amounts to fall in line with current CIS practice and not necessarily be prescribed. This can be set by the MANCO at an appropriate level for the	Noted. It is agreed that there should be a minimum investment amount; however the CIS manager can determine its own provided that it is not lower than that prescribed by the Registrar.

	specific fund as described and disclosed in the founding documentation.	
	Restricted Funds – for qualified investors including pension funds. Emphasis on appropriate mandate match to investor, disclosure, systemic reporting and a regulated framework. Flexibility in terms of investment criteria is proposed, with the emphasis on disclosure and reporting as the key elements. The minimum initial and subsequent investment amounts and terms to be disclosed, by the current industry practice is between R250,000 and R 1 million.	Noted.
	The naming convention "Restricted Hedge Funds" is however viewed as problematic and potentially misleading, as these funds in fact will have "unrestricted" mandates but restrict access to qualified investors. The proposal is to refer to this category as "Professional Investor Funds" which is in line with international practice.	The proposal is noted and it has been agreed to change the name to Qualified Investor Hedge Funds.
	Institutional Investors, including pension funds, should be able to invest in either of the 2 product categories, subject to the restrictions as per Regulation 28 of the Pension Funds Act in the case of pension funds.	Agreed. The type of investor will not be prescribed (Registrar of Pension Funds will determine criteria for investment by pension funds).
	The requirement to disclose client information is onerous. It would be helpful to workshop disclosures.	Disclosure is a fundamental part of regulation and supported internationally. The level of regulation will be considered. Disclosure is even more important for retail investors. . We will consider the extent of the disclosure where appropriate (for example in relation to qualified investors).
	The reference to "private arrangements" in this context needs clarification.	Noted. Please see response above.
	The issue of marketing and distribution (including a revision of FAIS to allow for specific categories of intermediaries with approval to advice on these products)	Noted.

	should be discussed.	
Retail Hedge Funds: The retail category will be regulated more closely by the Registrar, inter alia, by prescribing what type of assets may or may not be included in the portfolio and limiting the level of leverage permitted. They will be required to register in terms of the requirements of the Registrar. This category of investments will be available for retail investors, including institutional investors. Additional requirements may entail restrictions on the type of assets included in a portfolio, valuation and liquidity. A minimum investment of between Fifty Thousand Rand (R50 000) and One Hundred Thousand Rand (R100 000) will be prescribed.	We agree that "Retail Hedge Funds" should be required to have a high minimum investment limit, however the manager should have the discretion to apply a higher minimum than the proposed R100, 000.	Agreed. Fund may prescribe higher minimum but may consider a lower minimum investment, provided that it is not lower than that prescribed by the Registrar.
2.4. Retail Hedge Funds :	• Reference is made in this section to "retail investors" and "institutional investors", however as in 2.3 above, both concepts which are critical in distinguishing the proposed fund type from a "Restricted Hedge Fund", are not clearly defined. By inference, the impression is given that "institutional investors" be considered as Retail Hedge Fund clients, although some interpretations might argue that institutional investors (asset managers etc.) are by their nature "qualified" i.e. do Pension Funds fall within the definition of 'institutional investor'? It is our recommendation that pension funds should fall within the restricted hedge fund definition.	Noted. This will be clarified in the regulations, however institutional investors will be permitted to invest in retail hedge funds, and therefore will not be restricted only to the qualified hedge fund. Pension funds can invest in RHF or/and QIHF, subject to the requirements of the Pension Funds Act and Regulation 28.
	Consideration should be given as to whether the minimum	Agreed, this will be considered. Further, please see comments above.

	investment requirement is too high	
3. Definitions :	• Although hedge funds in South Africa are not currently regulated, market conduct is regulated through the Financial Advisory and Intermediary Services Act, No 37 of 2002 ("FAIS Act"). It is therefore sensible that the regulatory framework proposed for hedge funds within CISCA seek to achieve consistency with the FAIS and CISCA definitions as is appropriate.	Agreed.
	Consideration should be given to aligning all definitions in terms of the industry standards, e.g. Securities Services Act / Financial Markets Bill. This will provide greater consistency.	Agreed.
	• A set of standardised definitions of terminology should be developed in collaboration with industry stakeholders to further promote transparency and investor understanding. See **Annexure A – Terminology** as proposed definitions from ASISA.	Noted.
"Fund Administrator" means a hedge fund administrator who administers the trading, reconciliations, valuation and pricing for a hedge fund.	**3.1 Definition of "Fund Administrator"** We propose that the definition of "Fund Administrator" be amended to read "a hedge fund administrator who administers the trading reconciliations, valuations or pricing for a hedge fund" as a Fund Administrator may provide some but not all of the listed services.	Noted and agreed, we acknowledge that FAs may not perform all the functions described; specifically they do not perform any trades. The definition will be amended accordingly.
	This definition is slightly misleading, particularly where it is stated that it administrates the "trading" of a hedge fund. It is also not as comprehensive as it might be, with no mention of the fact that administration is performed both at an Asset and Investor level – i.e. Asset Administration and Investor Administration. Further to the above, there is no mention as to whether or not this entity needs to be a regulated / licensed entity, under FAIS or any other regulation to	Agreed. The definition will be reconsidered and will exclude trading. The fund administrator will have to be regulated or licensed.

	perform the relevant administration services. There is no mention of whether Fund Administrators are to regulated intermediaries.	
	It is not accurate to say that Fund Administrators administer the trading of a hedge fund; this function is more accurately attributed to the Prime Broker.	Agree, please see above.
	Third party administrators do not generally fulfil the functions of *trading or pricing*. The core functions are asset administration / fund accounting (which by definition includes reconciliations) and investor / liability administration.	Agreed, please see above.
***Derivatives*[1]*;* a "derivative" means a financial instrument, or contract, that creates rights and obligations and that derives its value from the price or value, or the value of which may vary depending on a change in the price or value, of some other particular product;**	**3.2 Definition of "derivative"** We propose that for consistency the definition for "Derivative" be removed and reference made to CISCA Notice 80 which defines listed and unlisted "Financial Instruments".	For consistency, the definition in the Financial Markets Act, 2012 ("FMA") will be used.
	Provides a definition of a derivative. We would suggest that this definition should align with the definition contained in the Financial Markets Bill namely: ""derivative instrument"" means any— (a) financial instrument; or (b) contract, that creates rights and obligations and whose value depends on	Agreed.

[1] Derivatives are financial instruments with values tied to the performance of assets (usually securities or bonds) or to benchmarks (usually interest rates). A plain vanilla derivative instrument is a future - an agreement to buy or sell a specific commodity or financial instrument at a set price on a stipulated date.

	or is derived from the value of one or more underlying asset, rate or index, on a measure of economic value or on a default event.	
	The international community has not yet been able to agree on a definition of derivative and therefore it would be inappropriate to attempt to define the term in this proposed piece of legislation. We would propose that the definition be aligned with the Financial Markets Act where the instrument evidencing a derivative has been defined. This consistent approach would provide greater certainty and would adopt the IOSCO definition of a derivative instrument namely: ‘‘derivative instrument’’ means any— (a) financial instrument; or (b) contract, that creates rights and obligations and that derives its value from the price or value, or the value of which may vary depending on a change in the price or value, of some other particular product or thing;”	Agreed.
	Derivatives have recently been re-defined in the Financial Markets Act, and it is suggest that the legislator align with this definition. (Derivatives are financial instruments with values tied to the performance of assets (usually securities or bonds) or to benchmarks (usually interest rates). A plain vanilla derivative instrument is a future - an agreement to buy or sell a specific commodity or financial instrument at a set price on a stipulated date).	Agreed.
“Hedge Fund” is a collective investment scheme whose portfolio uses any one or more of the following investment strategies: (a) leverage; (b) short positions; or derivative positions for the purposes of enhancing returns or to protect the assets against market exposures.	**3.3 Definition of “Hedge fund” ;** The definition of “Hedge Fund” differs from the definition written into the FAIS Act and as indicated in Footnote 4 the intention is to achieve consistency in this regard. The proposed definition is problematic because it would encompass any portfolio that used financial instruments for the purposes of efficient portfolio management. For example, many traditional portfolios use Top 40 futures to manage aggregate equity market exposure. Technically this	Agreed. We have noted the comments and will accordingly adopt the definition used by FAIS, with the necessary alignments.

	can constitute the use of either leverage or short positions at an instrument level, although not necessarily at portfolio level. Traditional portfolios adopting these or similar strategies would therefore inappropriately fall within this definition of “Hedge Fund”. We prefer the FAIS definition because it defines a hedge fund as having leverage and/or short positions at portfolio level.	
	The proposed definition implies that a Hedge Fund may only exist within a CIS environment. From 1.1 above however, it is not clear as to whether all funds (existing & new) fit into this environment, either voluntarily or by compulsion. Many non-hedge fund funds use derivatives for efficient portfolio management and these may now be captured as a hedge fund under this definition. Regulation 28 definition should be considered. In addition, leverage is not an indicator of risk therefore it is unclear as to why this is captured here. To align the FAIS definition to the CISCA definition may therefore not be wholly appropriate.	Agreed.
	• In principle we suggest that this definition is changed to “Collective Investment Scheme Hedge Funds are portfolio’s which…” In addition, existing collective investment schemes may use derivatives on the basis described in item (c). Hedge funds are already defined in FAIS and in Regulation of the Pension Funds Act. The current FAIS definition is as follows: “a portfolio which uses any strategy or takes any position which could result in the portfolio incurring losses greater than its aggregate market value at any point in time, and which strategies or positions include but are not limited to - (a) leverage; or (b) net short positions.” The FAIS Act will require amendment in order to align the definitions.)	The FAIS definition will be used, with the necessary modification.

	• Currently, certain collective investment schemes do make use of derivatives for purposes of protecting the assets against market exposures, as is allowed in terms of current legislation. If this definition is used, all other non-hedge fund collective investment schemes would be hedge funds or would need to stop using derivatives. We propose that FAIS definition is used rather than the proposed definition. Please provide clarity in respect of whether foreign restricted hedge funds (i.e. that are not marketed to retail investors in South Africa), would be governed by this legislation.	Noted, the FAIS definition will be used. Foreign hedge funds would enter the market in accordance with the provisions of section 65. Specific conditions for hedge funds will be considered.
	• The inclusion of …or (c) derivative positions has the potential to bring many existing CIS funds into the definition of a hedge fund, as any use of derivatives is ultimately for the purpose of enhancing returns of the portfolio (e.g. long ALSI future for portfolio construction) or protect the assets against market exposure (e.g. hedging market exposure using a short ALSI future). According to this definition, any other CIS fund that uses any derivative positions will be classified a "hedge fund".	Noted, the FAIS definition will be used.
	The term "Hedge Fund" is furthermore already defined under FAIS (BN 89 of 2007) as …a portfolio which uses any strategy or takes any position which could result in the portfolio incurring losses greater than its aggregate market value at any point in time---, and which strategies or positions included but are not limited to Leverage; or Net short positions	Noted, as stated above. We have agreed to use the FAIS definition of hedge funds.
	Regulation 28 of the Pension Funds Act also refers to the	Noted.

	above definition, but adds a conditions pertaining to the licensing of the FSP.	
	3.4 Definition of "Funds of Hedge Funds": We propose that "Restricted Funds of Hedge Funds" ("Institutional Funds of Hedge Funds") be allowed to invest in underlying "Retail Hedge Funds" but that "Retail Funds of Hedge Funds" not be allowed to invest in underlying "Restricted Hedge Funds" ("Institutional Hedge Funds").	Agreed. Qualified investor hedge funds will be permitted to invest in retail funds however the opposite will not be allowed.
	The definition states that a Fund of Hedge Funds ("FoHF") may only be "Retail" or "Restricted", and that no combination would be permissible. Aside from the lack of clarity in terms of the definitions of Retail and Restricted (Retail, institutional & qualified clients), the question arises as to why a "Restricted" FoHF would not be permitted to also invest in the more onerous / controlled environment of the proposed Retail fund.	Clarity will be provided in the regulations. As indicated above, a qualified investor hedge fund will be permitted to invest in a retail hedge fund.
Definition of hedge funds	In instances where a Fund of Hedge Funds meets the criteria for being a Qualified Investor under CISCA, it is kindly requested that it be recognised as such. The ensuing distinction between a "Retail" and "Restricted" Fund of Hedge Funds in instances where these qualifying criteria are met may consequently be deemed to be superfluous.	All funds whether fund of hedge funds or single manager will be subject to the regulations. The regulations will propose the authorisation of a hedge fund and that fund will be able to invest into other funds. A retail fund will however not be permitted to invest into a qualified fund; the reason behind this is to avoid regulatory arbitrage.
	A widely used investment vehicle currently utilised by Funds of Hedge Funds is the use of segregated portfolios (also known as managed accounts). The acceptable treatment of this widely used vehicle is still an important matter which should be elaborated on within the proposed legislative framework. Eligible assets for a Fund of Hedge Funds have not yet been detailed in the proposed framework. We foresee a potentially disruptive impact on the industry if the conditions of 3.4 are enforced in its	A fund of hedge funds will no longer be provided for as a separate portfolio, however the requirements for either a retail or qualified fund will apply equally. CISCA does not provide for multi manager funds.

<table>
<tr><td></td><td>current form, i.e. that “a combination will not be permitted”. It is kindly requested that a similar treatment be afforded to Funds of Hedge Funds as is afforded to Funds of Funds and Multi-Manager funds currently under CISCA.</td><td></td></tr>
<tr><td></td><td>The reasoning as to why a Restricted Hedge Fund of Funds cannot invest in a Retail Hedge Fund should be further elaborated on and explained, as it may be more appropriate to only limit retail Funds of Funds.</td><td>Please see comment above, this aspect will be clarified in the regulations.</td></tr>
<tr><td></td><td>We suggest that combinations must be permitted but classified as restricted.</td><td>Noted, please see response above.</td></tr>
<tr><td></td><td>It is understandable that a retail hedge fund of fund will not be allowed to invest in a restricted hedge fund, but it makes no sense that a restricted fund of hedge fund may not invest in a retail hedge fund.</td><td>Please see above, a qualified fund will be permitted to invest into a retail fund.</td></tr>
<tr><td></td><td>• The detailed regulation needs to clearly distinguish between rules common across all hedge fund product categories, and those specific to a category as per the matrix below.</td><td>Agreed. Will be clarified in regulations.</td></tr>
<tr><td></td><td>• In brief, Restricted Hedge Funds should be able to invest into either restricted or retail hedge funds, as well as other funds, including existing CIS funds.
<table><tr><td></td><td>RETAIL FUND</td><td>RESTRICTED FUND (Professional Investor Fund)</td></tr><tr><td>SINGLE FUND</td><td></td><td></td></tr><tr><td>FUND of FUND</td><td></td><td></td></tr></table></td><td>Noted, please see comments above.</td></tr>
<tr><td></td><td>3.5 Leverage;
• We propose that the definition of “Leverage” be deleted.</td><td>The definition of leverage will be aligned with the terminology as referred to at 6.7. We do not agree with the proposal to delete.</td></tr>
</table>

	This mitigates the risk of too narrow a definition of leverage and instead places reliance on section **6.7 LEVERAGE** which articulates the terminology more broadly.	
	In the footnotes to this definition, Footnote No. 5 ends with the phrase: Only limited partnerships will be permitted." This phrase appears to be incomplete and/or out of context – perhaps more aligned to Footnote No. 7 dealing with partnership structures.	Noted, agreed.
	3.6 **Definition for Prime Broker** : The use of the term "an authorised financial services provider" appears to have been used rather loosely with no clear definition as to what regulation is required for entities not regulated under the Banks Act. , for example, does such provider need to be an authorised "Financial Services Provider" as defined by FAIS, or a provider of financial services regulated or sanctioned for example by the Minister under special powers as may be the case in the proposed Financial Markets Bill. Additional criteria relating to a Prime Broker will be further prescribed as per clause 8.1.6 has been overlooked when compiling this definition. In terms of the services provided by a Prime Broker as stated in the definition, it should be noted that not all Prime Brokers operating in South Africa currently provide or are able to provide all of these services. In other words, the services provided depend on amongst other things, the Prime Broker's legal entity structures, licences, and may exist in various combinations depending on client needs. It is also worth noting that not all clients of Prime Brokers are necessarily Hedge Funds. .	PB does not have to offer all the services as defined. It is the intention to permit the use of PBs that are regulated. This includes the Banks which are regulated under the Banks Act, 1990 and the authorised users which are regulated by the JSE. For purposes of investor protection the principles of segregation and identification of assets will be applicable. This is also in line with the provisions of the Financial Markets Act.
	Prime brokers are not necessarily banks but JSE members (which are not authorized Financial Service Providers)	Noted, this will be amended to authorised users rather than authorised FSPs.

3.7 Qualified Investor definition:	It is too restrictive and does not clearly point to specific type of investor.	Comments are noted, the definition will be revised with more relevance. See comments above.
	It excludes all investors who do not currently trade in securities but may have the necessary skill and knowledge to be able to do so.	Investors who do not currently trade in securities but can show a knowledge and expertise in securities and hedge funds will be permitted to invest, provided they also have the minimum investment amount.
	It discriminates against people with smaller portfolios – a smaller portfolio could be appropriate in the context of a hedge fund investment.	We do not agree, such people can invest in a RF.
	It discriminates against most financial planners, representative investment professionals. The young investment professional is effectively barred from entering – he cannot start trading small and build up assets and knowledge.	Investor protection demands that we protect investors against people who are not adequately skilled or experienced.
	The one year period is too short and should be lengthened to a proposed 3 to 5 years.	Noted, We will reconsider the period as suggested and also align the provisions regarding the qualifications of the advisor with the requirements for a Cat IIA FSP.
	The rules for "Qualified Investors" are complex and potentially exposed to manipulation. We propose that the definition be removed and that reliance rather be placed on the minimum investment threshold of R1 million. Reference should be made to the FAIS Act Category IIA requirements which includes inter alia that the mandate be explained to potential investors to allow them to identify the suitability and risks associated with the investment. This places the onus on the Hedge Fund provider to ensure that the relevant information regarding the investment is provided within the context of the investors' experience and expertise.	Noted. We would prefer additional criteria and do not only want to rely on the ability to meet the minimum investment amount. As stated above we will review the criteria and also consider aligning the advisor's requirements with those of the Cat IIA FSPs.
	The definition appears to be incomplete and potentially inappropriate to the domestic market, thus potentially	You must be a qualified investor to invest in QIHF; this may include a pension fund, subject to the criteria determined by the Registrar of

	excluding certain parties who in fact may well be "qualified" by alternate criteria. It is unclear as to whether one must be defined as a 'Qualified Investor' as per the definition to invest in retail hedge funds and/or restricted hedge funds? It is currently unclear as to whether the asset managers qualify under this definition on behalf of their clients or whether the underlying clients need to independently qualify in order to invest. These requirements are ambiguous and it is unclear as to whether Pension Funds qualify as "Qualified Investors".	pension funds. The point is valid and noted, consequently the definition of a qualified investor as contained in the framework will be amended. This aspect is still under consideration.
	3.7.1: The volume of transactions executed by a client in a given period is not necessarily a measure of the client's level of understanding or experience. In addition to this, the phrase "significant size" is a subjective measure as to how it would be defined in practice or what 'average frequency of at least 10 per quarter' would include, and is therefore open to interpretation relative to the investor's frame of reference. The rest of the definition is arbitrary and impossible to validate.	Please see above, the definition will be amended to address concerns.
	3.7.2 The minimum investment amount is not necessarily a measure of a client's level of understanding or experience of financial markets and products.	Noted and agreed, however the minimum investment amount will be a useful prerequisite.
	• 3.7.3 This definition is weak, and vague. Phrases such as "professional capacity" and "securities investment" are both subjective and open to wide interpretation.	Definition will be amended, please see comments above.
	It is kindly requested that the definition of a Qualified Investor be expanded to include life companies, in cases where a life company meets the criteria as stipulated.	Life companies are included in the definition of a person, which includes a juristic (legal) person the definition will therefore not exclude them.
	Although we agree with this concept further consideration needs to be given to the requirements. Carrying out frequent transactions appears to contradict with long term investment behaviour, specifically in the context of Section 9(c) of the Income Tax Act. It is also contradictory for the FSB	Noted, please see comment above. We agree that one year of working in the industry may not necessarily qualify an individual to give investment advice and we will thus review these proposals.

	to authorize Financial Service Providers and then, in this Act to prescribe further requirements (“has worked for at least one year in the financial sector in a professional capacity which requires knowledge of securities investment”). Lastly we suggest that when guided by an appropriately approved Financial Services Provider any person should be able to invest into any product, since the investor could in any event gain access to this risk profile by virtue of a segregated account or as part of a larger portfolio. (*Aside from being identified by the types of investors who invest in them, hedge funds are identified by the investment strategy that they adopt. All strategies will be allowed but proper disclosure to clients will be a requirement. In addition the strategies must be specifically incorporated in the founding documents.)	
	We are of the opinion that neither 3.7.1 nor 3.7.2 is a reasonable measure of an investor's capability and expertise within the hedge fund industry. In our opinion, these criteria are based purely on arbitrary figures and amounts and exclude some very capable and experienced investors from investing in hedge funds. Furthermore, it is a great concern that some investors that have been invested in hedge funds for 2 to 5 years, will simply be excluded from the definition of a qualified investor because their investment may be less than R1 million. We are also of the opinion that many of the South African "investments" where investors have lost vast amounts of money, where due to wrongful advice given by financial advisors. Many of these "schemes" had at its forefront financial advisors with very little knowledge and experience, who acted negligently and succumbed to blatant conflicts of interest. We propose, therefore, that the advisors rather be regulated more stringently. This will ensure that every investor that do make use of an	The concerns are noted and the definition will be amended to address them. Please see above.

	appropriately qualified and registered investment advisor, receives the best possible advice and will be allowed to invest in hedge funds as a qualified investor. We, therefore, propose the following criteria for a qualified investor (an investor still to meet only 2 requirements):	
	3.7.1 The investor, or its representative in the case of a juristic person or trust, is an individual with a commercial or legal degree or other professional qualification as determined by the Registrar has carried out transactions of a significant size on securities markets at an average frequency of at least 10 per quarter over the previous four quarters; (Possible qualifications may include: B. Com, LLB, CA (SA), CFA etc.)	Agree that advisers must be regulated closely as is done under the FAIS Act. We will propose a minimum level of knowledge for advisors.
	3.7.2 The minimum investment amount of R1 million, R250 000 per portfolio; 3.7.3 The investor or his authorised advisor or its representative in the case of a juristic person or trust works or has worked for at least one year in the financial sector in a professional capacity which requires knowledge of securities investment or the investor's authorised advisor has the required regulatory licence from the Financial Services Board to advise on hedge fund investments;	Existing investors will not be affected however if they exit and reinvest they will be subject to the new regulations.
	3.7.4 The investor or his authorised advisor, or its representative in the case of a juristic person or trust, has been invested in a hedge fund operated by a FSB registered hedge fund manager (i.e. with a IIA-license) for more than 1 year prior to the effective date of the regulations.	The amendment will include a tightening up of the requirements regarding the advisors. The suggestions are noted.
	I believe that the definition of qualified investors should be broadened to include high net worth individuals with a net asset value above a certain threshold, employees of the hedge fund as well as their relatives, and possibly also investors who have previous experience of hedge fund	The definition will be revised taking comments into account. Existing investors will not be required to disinvest from funds.

	investing. I propose to eliminate 3.7.1 because I fail to see how being a day trader makes you a suitable hedge fund investor (in fact, I would most certainly avoid taking in an investor who has such an apparent short term mentality). I also believe that current investors in hedge funds should be "grand-fathered" to ensure that they are not forced to disinvest from restricted funds and incur tax liabilities.	
	That the minimum investment for qualified investors be altered to R500 000.	Disagree, the minimum investment amount will remain as R1 million however this does not apply to further investments.
	Firstly we believe that there should be a distinction between a qualified investor investing in a restricted hedge fund and a qualified investor investing in a restricted fund of hedge funds. The argument for this is that one of the major reasons why an investor would pay an additional fee to appoint a fund of fund manager as opposed to investing directly into the hedge funds is to obtain the experience and knowledge of the fund of fund manager who invests on his behalf in various hedge funds. The investor therefore, by definition, immediately becomes qualified by appointing the manager with the necessary skills and experience. The client therefore, does not necessarily need to understand all the various strategies, trading activities and asset classes of the underlying hedge funds of the particular hedge fund of fund. The definition of a qualified investor in the case of a restricted fund of hedge funds should therefore be less stringent as you clearly need less of an understanding and insight into hedge funds to select a good fund of hedge funds as opposed to a pure hedge fund. The risk is also greatly reduced.	We do not believe, at this stage, there is a need to distinguish between the two, as this could add complexity. In the circumstances we have also determined that it is not necessary to have a fund of hedge funds as a separate category of hedge fund. A qualified investor would be able to invest in a qualified investor hedge fund regardless of whether it is structured as a single manager hedge fund or a fund of hedge funds.
	3.7.1 We believe that this criteria is excessively restrictive in the case of a restricted fund of hedge funds and even in the case of a restricted hedge fund, it is very vague as it will be very difficult to determine what the definition of a	We have decided to no longer have a separate category for funds of hedge funds. In respect of significant size, the comment is acknowledged and we will accordingly review this proposal in the regulations.

	significant size will be. For example, in the case of a person with net assets of R100 000, his significant size may be R10 000, but for a client with net assets of R100 million, it may be R10 million. We would propose that 3.7.1 has more to do with the client's qualifications and investment history as opposed to trading activity.	
	3.7.2 We believe a minimum investment of R1 million is overly excessive and will reserve restricted hedge funds only to the very wealthy as it would be prudent for any investor to invest in at least 3 to 5 different hedge funds for the purpose of diversification, especially considering that many hedge funds are very focussed to a specific strategy or asset class, making it even more important to diversify than in the case of an equity unit trust investment. If one then considers that an investor who invests in three hedge funds will need R3 million under the proposed legislation and that it is further unlikely that an investor would allocate more than 15% of his total portfolio of investments to hedge funds, it becomes clear that the proposed minimum amount is excessive and has the effect that only very wealthy people with net assets in excess of R20 million will be able to invest in this category. This will have a very negative effect on the industry or it will have the effect that many investors that see the value in hedge funds may be tempted to allocate more than what they should into one hedge fund, raising their risk of loss substantially. Our proposal would be that a minimum investment amount should not be used, but rather a referral to the net assets of the investor. If it is however decided that there must be minimum investment amounts, we would recommend that it should not be more than R250 000 in the case of a restricted hedge fund and more than R100 000 in the case of a restricted fund of hedge funds.	Qualified investor hedge funds will not be subject to stringent regulations and as a result they must only be available to persons who qualify in terms of the prescribed criteria. The R1m is a minimum initial investment amount and further investments will not be subject to this requirement. This will be further clarified in the regulations.
	This definition elicited numerous discussions amongst the	The comments are noted. We have considered the issues raised and

	members of the working groups, as well as comments from individual members as listed below. The criteria as published in the proposed framework are based on that specified in Annexure II of the **Markets in Financial Instruments Directive** (2004/39/EC) of the European Union (MiFID), and there are concerns about the appropriateness of these criteria in a South African context and the practicality of implementing this. The work groups consolidated views were previously communicated to the FSB after the presentation in June, as below.	accordingly will amend the prescribed criteria to be more aligned to the South African context in respect of investors.
	Investor access to the portfolios A sound decision to invest in a portfolio is a function of a well-considered evaluation of the attributes of a portfolio and its congruence with the specific financial needs, circumstances and motives of the investor. It is often difficult to ensuring that this is done prudently and appropriately within a regulated framework, without being inequitable with respect to access. While other jurisdictions may have opted for portfolios with limited access, qualified by a minimum amount, this simplistic metric is rather blunt as a policy instrument. It takes no cognizance of the overall balance sheet of the investor and it also entrenches a maxim that certain portfolio strategies are only beneficial to certain investors.	Comments are noted and will be taken into account in our revision of the criteria with respect to qualified investors.
	Investment by definition is a long-term activity and it therefore becomes very difficult to justify why a risk mitigation strategy by a hedge fund is inappropriate for certain investors, yet appropriate for others. Certain investors may have sufficient expertise of their own to make an informed decision, and so the European Union has	Noted. That is why we have provided for a tiered or gradual approach of regulation by having two types of hedge funds.

	considered a set of criteria that may be considered to be representative of appropriate knowledge or experience when making a decision to invest in a hedge fund portfolio.	
	The Committee is of the view that the matter by its very nature, fails accurate and equitable definition. We therefore recommend that advisors need to be suitably qualified and graded (by product category approval as they would for other products) to give advice on these portfolios. Investors should then be allowed access to a hedge fund portfolio in one of the following ways: 1. Via a registered advisor, graded to provide advice on these portfolios (*appropriate advice*); 2. By virtue of the investor's registration as a Financial Services Provider (*appropriate skill*); On his or her own cognizance, having signed a 'Statement of Responsibility' (*appropriate financial standing*).	Noted. We have made a distinction between the investors by having qualified investors who will be able to invest in a product that is not subject to very stringent regulation.
	It is proposed that a *Restricted Fund of Hedge Funds* be deemed as a Qualified Investor. Minimum subscription requirements will be set on a fund level and disclosed in the fund founding documents. The MANCO should develop its own requirements in the regard.	We have decided not to include a separate category of a fund of hedge funds and will only have qualified and retail hedge funds. We are of the view that minimum subscription requirements should be set in order to protect investors, however managers are welcome to amend their subscription requirements as long as they are not below the minimums set.
	3.8 Definition of Risk management Programme: The proposed definition does not cover who is responsible for the implementation of the programme, and whether or not parts thereof may be outsourced to a third party vendor for monitoring etc. We require some understanding as to what the Regulator will do with this information once provided and as such, we require some confidentiality provisions inserted so that the information supplied will not be shared with third parties. We require some clarity as to the purpose of having a risk management programme if one	Risk management will be required for both listed and unlisted securities. In respect of confidentiality, members of the FSB are bound by the secrecy provisions of the FSB Act, 1990 (section 22) and accordingly this is already provided for in law. The process includes both listed and unlisted securities. QIHF: The regulations will require a QIHF to have a board of directors who will act as the governing body of the fund. The board will be responsible for risk management of the QIHF. The risk management function must be independent of the investment management

	is only required for unlisted securities. It is unclear as to why the requirement is only applicable in respect of unlisted securities.	function. RF: The Manco will be responsible for risk management of the fund. The risk management function must be independent of the investment management function.
	We are concerned whether existing trustees have the appropriate skills to fulfil this role. We suggest that large institutions with independent risk departments or specialized risk service providers would be better equipped. These we suggest that these "trustees" should be subject to a registration process.	Only retail hedge funds will require a Manco and a trustee. The Manco will be responsible for risk management. This function may be outsourced, however accountability remains with the manager (Manco in a RF). Trustee's responsibility is around compliance; they must ensure compliance with risk management policies.
	"Risk management programme" means a programme established by a manager and agreed to by the trustee. It must contain procedures to ensure that all applicable risks pertaining to the hedge fund can be identified, monitored and managed at all times. This includes market, liquidity and counterparty risks, as well as the exposure of the fund to other risks, including operational risk.	Outsourcing of risk monitoring can be allowed, but risk management which is a proactive approach remains the responsibility of the manager of the Manco, or the board of directors of the QIHF. The regulations will cater for other risks such as operational risk, market risk, liquidity risk, counterparty risk, etc. and will apply to both types of hedge fund. In respect of operational risk for example, the regulations will require the independent valuations of all positions by an independent 3rd party. At this stage, we consider this a critical prudential and investor protection provision. The minimum valuation period will be specified, but if it is a weekly dealing fund then the valuation of the fund must take place at least weekly. The regulator feels that daily valuations would only be required for funds offering daily dealing (liquidity) to the market. Valuations for all funds must however take place at least monthly.
	4.1 Legal Structure	

	• An en commandite partnership – is a limited partnership similar to a silent partnership, save that the partner en commandite limits its liability to its co-partners for the losses of the partnership to an agreed amount, on condition it receives a fixed share of the profits. In the hedge fund environment the silent partners contribute funds but are liable only to the extent of the capital invested in the partnership / scheme. All these structures, referred to above, can be accommodated under the Act provided that the principle of segregation and identification of assets as contained in section 2(2) of the Act is satisfied, that is to say, there must be a clear separation of assets. It must be emphasized that the structure of the hedge fund is separate from the manager thereof. Notwithstanding that partnerships are a viable structure for hedge funds, hedge funds which intend targeting retirement funds must comply with the requirements of the Registrar of Pension Funds There is no guarantee that because the agreement will specify that the partner's (the pension fund's) liability will be limited to the value of its contributions, that this necessarily means the pension fund is protected from creditors.	Agree, the structure of a hedge fund should be separate from the manager. With respect to investment by pension funds this will be determined by the Registrar of Pension Funds. The requirement for segregation of assets is a fundamental in the law of collective investment schemes. For both the QIHF and RF there must be segregation and identification of assets in the name of the hedge fund at the custodian level. . The assets of a hedge fund cannot be held in the name of the PB. The assets of the HF must, at the custodian level, be registered in the name of the HF – applicable to ALL hedge funds. The requirements of regulation 28 will be taken into account to the extent that they are relevant for purposes of CISCA. It should however be borne in mind that the considerations made by the Registrar of CIS may be different from those of the Registrar of Pension Funds. CISCA contemplates any type of structure and accordingly all structures will be allowed. We will retain definition of "scheme" – in whatever form.
	If all hedge funds must comply with CISCA and the requirements there, it follows that a hedge fund that is not registered in terms of CISCA may not be marketed to any investors in SA including institutional investors such as pension funds. Therefore, it is strongly recommended that the requirements of Regulation 28 and CISCA are aligned.	Noted, the requirements will be aligned to the extent that they are relevant.
	• See previous comments to 1.3.	RF will be required to establish a Manco while QIHF will not be required to establish a Manco. CISCA permits a scheme "in whatever

	It is not clear from this paragraph what the intended future legal vehicle under a new CISCA regime will be, whether all of the existing structures will be viewed as constituting collective investments schemes after declaration, and if a conversion to a different vehicle under CISCA is anticipated as part of the transition phase.	form" and so a legal vehicle has not been prescribed or proposed.
	4.2 Legal Structure • This paragraph looks to address the required legal structure, capital and reserving requirements for hedge fund managers. This is somewhat in contradiction to 1.4 which states that the intention of the proposed framework is to regulate the Hedge Fund, and not its financial services providers. In addition to the above, and notwithstanding, Footnote No.2 which states that the context of this document does not deal with Category IIA Fund Managers regulated under FAIS, bearing in mind that the vast majority of existing Hedge Fund Managers currently hold Category IIA licences, we require clarity as to whether or not capital and reserving requirements for a manager under CISCA would be in addition to such manager's existing "capital" and "reserving" obligations under FAIS.	The paragraph is not a contradiction. A hedge fund manager is currently regulated under the FAIS Act, and this is the investment manager who manages the assets of the hedge fund NOT the manager who managers the scheme itself. If a Cat IIA FSP also registers as a CIS manager under CISCA, such entity will then have two licences, i.e. as a CAT II as well as a MANCO. With regard to qualified investor hedge funds, the existing structure may be retained, however the entity that is responsible for governance or the operational affairs (expected to be the GP in the case of a partnership) of the fund would be required to register as a CIS manager while the Cat IIA FSP continues acting as the investment manager in terms of its registration under the FAIS Act, which could mean additional capital or reserves requirements (at the level of the governing entity).
	We agree that there are structural weaknesses in existing hedge fund structures, some of which have been mentioned, and propose that the legislator rather prescribe a sound structure.	Given the already existing different legal structures, it is imperative that we do not unduly disrupt the industry, and hence we contemplate accommodating all existing structures for now. Some of these structures, where appropriate, will be strengthened by (further) capital requirements to ensure financial soundness and investor protection. These requirements will be separate from the capital requirements prescribed for a Cat IIA FSP, depending on the nature of business conducted by the manager.
	5. REGISTRATION	

	The role of a management company (MANCO) and the necessity of a MANCO for both the envisaged product categories were points of debate. The view is that there should certainly be a requirement for RETAIL Hedge Funds, however there were differing views on such a requirement for RESTRICTED Hedge funds. The suggestion is that Management companies should be suitably graded, given the added responsibilities associated with running sophisticated portfolios. A management company would either have a standard license for CIS schemes in securities, or a grading pertaining to hedge fund portfolios, with concomitant risk management, valuation and administrative responsibilities. Prudential requirements should reflect the grading of the management company and a tiered approach could be appropriate. An existing management company wishing to launch a hedge fund portfolio, whether retail or restricted, would have to apply to the FSB for the additional grading and a license to do so. Paragraph 5 of the FSB's proposal captures these criteria. Furthermore, the hedge fund portfolios should be housed in a separate scheme from standard schemes in securities in order to separate the different portfolio risks. Portfolio managers whose business (and costing) model does not include the infrastructure to maintain a proprietary management company license, should have the option to secure a professionally hosted license, with a suitably qualified and experienced entity, as is the case with third party administration. This would represent a new development in the market and provide a professional long-term licensing option for managers. This possibility is the subject of broader discussion with the Regulator. In the meantime, it should be possible for portfolio managers to	The MANCO structure will only be applicable for a retail hedge fund while the qualified investor hedge fund will NOT be required to establish a MANCO. In the QIHF, the entity / person responsible for the operational activities of the fund will be required to register under CISCA retaining the existing structure with a separate Cat IIA FSP managing the assets. The retail fund will be required to establish a MANCO which will be the registered entity under CISCA. An existing MANCO will be permitted to establish a separate hedge fund scheme. The FSB will set requirements for registration as a MANCO therefore will not have grading requirements. If an existing manager wants to manage a hedge fund will have to register a scheme which must comply with the relevant requirements. . As indicated professional long term licensing may be considered however in terms of existing legislation the registrar will permit third party naming for hedge funds. In terms of a transition process, this will be provided for with an adequate transitional period. Noted and agreed.

	have access to a hosted license per Board Notice 778 of 2011: Determination of the Limits and Conditions for Third Party Named Portfolios of Collective Investment Schemes. The regulatory requirements during a transition phase and process to either set up a Manco or arrange for third party hosting should be clarified. There should be exemption from certain requirements for a realistic and specified period, as well as a clear and orderly process to allow for the various transition matters to be dealt with. Most existing structures are controlled by other legal entities (such as General Partners, Trustees and Directors) and for them to be separated would require structural changes ahead of the declaration or during a transitional period.	
	The standard application process for current CIS should apply, with some appropriate additional requirements and information.	Agreed.
	• Per 4.2 above, and in contradiction to 1.4, this section deals with regulation of the service providers under CISCA.	No, this section deals with registration of a CIS manager of a hedge fund. The requirements will be clarified in regulation in respect of both the QIHF and the RF.
	• Question: are you envisaging to register all now Category IIA FAIS licensed hedge fund managers as Manco's in terms of the new framework?	No. See above regarding the requirement for establishment of a MANCO. Only the RF will be required to establish MANCOs. In a QIHF, the person responsible for the day to day operations of the fund (i.e the general partner in a partnership) will have to register as the CIS manager. This may or may not be the Cat IIA FSP.
	• (and 5.2) The proposal currently in the framework is that current hedge funds must be issued by a management company as per CISCA. Many asset managers do not currently have a CIS licence. However, these asset managers are registered in terms of FAIS and meet the	Asset managers of QIHF will not require an additional licence however the person responsible for the day to day functions of the fund (e.g a general partner in a partnership) will have to obtain a CIS licence.

	requirements there (including capital adequacy requirements). The introduction of a need for a further MANCO licence where such hedge funds are only targeting qualified investors would, in our view, introduce an extra layer of costs with no immediate benefit. Accordingly, we would propose that asset managers of restricted hedge funds should not require an additional management company licence.	
5.2 Registration as a CIS Manager Required	Like many others in the industry, we are a relatively small manager, and I am concerned about the cost and time implications of this registration. The information required for registration listed in points 5.3.1 to 5.3.17 appears to be a duplication of the information we already submitted for our cat IIA license (which, as mentioned above took a significant amount of my time). Additionally, we only charge investors if we make money for them (there is no management fee, only a performance fee), so I am concerned about increasing our costs. I fail to see the benefit to investors of Cat IIA managers with Restricted Funds registering a Collective Investment Scheme. However, if there is some value here that I am missing, perhaps a more effective way would be an automatic conversion of all Cat IIA managers to collective investment scheme managers?	Qualified funds will not be required to register a separate manager, however they will be required to register as a hedge fund through the entity responsible for the day to day affairs of the fund. They will be required to have a governance structure. Only the retail fund will be required to register a manager as stipulated.
	This paragraph states that Category IIA providers will "be required to procure the registration of collective investment scheme managers for the purposes of the hedge funds they currently manage". This suggests that existing hedge funds will need to be included under one of the proposed CISCA fund options, i.e. legacy funds will need to be either Restricted or Retail. In addition, it is not however clear whether or not the managers will still require their Category IIA status. If yes, then it would appear that there will be a large amount of duplication in terms of registration,	A QIHF will be required to register as a manager under CISCA, however it will not be required to establish the MANCO structure contemplated by CISCA. Smaller funds running a QIHF will not be required to have a Manco.

	reporting, capital and reserving requirements etc.	
	Financial services providers that are currently registered as category IIA financial services providers will be required to procure the registration of collective investment scheme managers for purposes of the hedge funds that they currently manage. *We suggest that this should only be applicable to retail hedge funds. Fit and Proper requirements should not be regulated by the Registrar of Collective Investment Schemes as these criteria do no relate to structure of the vehicle but the people which are comprehensively regulated in terms of FAIS.*	If a Cat IIA FSP intends establishing a retail hedge fund they will be required to establish a MANCO however if the intention is to continue as a qualified hedge fund there will not be a requirement for a MANCO however the entity responsible for the day to day affairs of the fund will be required to register as a CIS manager (because the law will deem every hedge fund a CIS) and will have to have a governance structure (responsible for fiduciary oversight).
	The proposed framework is relatively vague regarding which of the regulations will be applicable to the restricted hedge fund category. For example, it is difficult to conclude whether or not a restricted hedge fund will also be required to have the fund registered on a platform of a CISCA manager. Should this however, be a requirement, we would like to object to this for the following reasons: It will erect a very large barrier to entry that may eliminate many of the smaller hedge funds in South Africa as it only becomes financially feasible to erect a CISCA manager when the manager has assets under management exceeding R1 billion. Many of the hedge fund managers that we are aware of have significantly less assets under management than this and many of their strategies are also not capable of handling such large funds and subsequently, they usually cap long before they reach the R1 billion mark. This would leave them in a situation where they will be forced either to sell their business to a larger entity and be employed by this entity (something that will be very destructive to the hedge fund managers business) or secondly, to make use of the license of a CISCA manager as in the case of the white labelling of unit trust funds. This practice of white labelling however is a	The practice of white labelling was reviewed and replaced in 2011 by what are known as third party named portfolios which permit the registration of a fund managed by an FSP under the licence of a registered CIS manager. The restriction in this regard is that where there is no intention by the third party (the FSP) to establish its own MANCO, the name of the portfolio must be co-named (i.e. bear the name of both the licensed CIS manager and the FSP). If the intention is establish its own MANCO, the FSP can have an incubator portfolio with the licensed manager.

	practice that the FSB is currently re-evaluating and the FSB is currently not approving any additional white label funds. An example of this can be found with Metropolitan Collective Investments who popularized this method and have the largest amount of white label funds on their platform. They have however, confirmed that the FSB is not approving any additional white label funds and therefore this strategy may also not be an option in the future. Even if this strategy would be allowed by the FSB, it will incur an additional cost to the hedge fund manager and its clients. It is therefore clear that such a regulation whereby it will be required for funds to erect their own CISCA managing company or make use of another CISCA manager, will to a large extent favour the big companies and eliminate many smaller managers who have excellent track records. The solution to this may be that there may be separate legislation regarding a CISCA manager, who intends to only host restricted hedge funds on his/her platform with these regulations specifically aimed at making the CISCA manager more financially viable for funds with fewer assets under management.	
	It is unclear if the intent of this regulation is to force hedge fund managers to register a collective investment schemes management company that must comply to all the regulation as stipulated in the Collective Investment Scheme Control Act. If this is the case, we would like to object to this for the reasons mentioned under the 'General Concerns' section of this letter as it will give an unfair advantage to the large managers who will bully the smaller managers either into selling their businesses to the larger companies at a discounted price or outsourcing these services if the FSB allows this (see case of unit trust white labelling for additional fees).	Please see comments above. Smaller funds operating (only) a QIHF will not be required to establish a MANCO. A fund will either be retail or qualified. A (manager of) QIHF will not be required to register a MANCO.
	Footnote 6 – Identification of Hedge funds – strategies	Hedge Funds have mandates and mandates allow for parameters to

	It should be noted that hedge funds are known for changing their strategies without notice and in a short period of time. This is the case as hedge funds are adaptive and innovative, and thus as such change their strategies to adopt to the prevailing market conditions. This is one of the reasons why hedge funds databases are often not 100% accurate – as funds change from one strategy to another. Care should thus be taken, as hedge funds will have to notify investors of any such changes (as this will influence the fund prospectus and mandate previously seen and agreed to by investors).	change, whole strategies cannot be changed without advising clients.
	• This section again focuses on the fund manager, and not the fund, and for the most part is duplication of what is already covered under FAIS requirements for FAIS registered service providers. It must also be noted that some service providers such as Administrators, some Prime Brokers etc. do not currently fall within the FAIS Act.	The investment manager will be regulated under FAIS and the fund will be registered and managed under CISCA. Prime brokers are required to be regulated entities, while they may not fall within the FAIS Act they are regulated either by the SARB or the JSE.
	• *Also see under 6.7 below comment from (NOVARE)*	
	We suggest that the standard CISCA requirements should apply appropriately enhanced as necessary.	Noted
	5.3.7 It is unclear why the physical addresses need to be collected. If this is for inspection purposes, under which authority will this power be invoked?	The Registrar must obtain the details of these persons as they are the ones responsible for the fund. This is a standard registration requirement.
	5.3.10 It will be difficult (especially in the case of Restricted Hedge Funds) to provide a full list of prime brokers, and especially counterparties at the registration stage as this could change	It is accepted that changes can take place, but the Registrar will require details at registration. Any changes can be provided in the report to the Registrar. We acknowledge that more than one PB could be used.

	periodically. The process for concluding an agreement with a prime broker or other counterparties should be agreed upon between the various parties involved, including the trustee. Note that more than one prime broker could be required / used.	
5.3.13 Details of Administrative staff:	Surely this should include the details (names and curriculum vitae) of all staff participating in general/core business function of the fund.	This is restricted to the day to day management of the fund (and not only to the investment managers?) as the focus is on accountable or responsible staff (this will be the board of directors in the case of a QIHF). It relates only to the fund management. In respect of the QIHF the details of the board of directors will be required. The regulations will clarify exactly what information is required.
	• This paragraph goes further to suggest that the names and curriculum vitae of all management staff responsible for administration will be required. It is not clear if this relates only to the fund manager, or to the various service providers including auditors and lawyers. If the latter, this may prove to be impractical to maintain over time, especially where a fund utilises several service providers. As Hedge Fund Managers are regulated under category IIA licence where all the relevant documents and details have already been provided, it is unclear as to why additional information needs to be provided.	No, this is not a requirement for the service providers' details, but effectively for the executive and non-executive management of the fund
	5.3.16 This implies that all funds will follow the current legal structure within CIS. Footnote 9 and other parts of the framework text seem to allude to the possibility that other legal vehicles could be utilised.	Yes. Only the RF will be required to follow the CIS legal structure, however the scheme can be in whatever form as provided for in CISCA. QIHF will not be required to establish a MANCO.
	5.3.17 Risk Management Programme: It might be beneficial to explicitly state that the risk management programme should include a risk management system of an integrated software nature. It is becoming global best practice for hedge funds to	The appropriate system will depend on circumstances of each case and should be strategy aligned and will be the responsibility of the board of directors of the QIHF and the Manco (if a RF is being managed) to decide on the best form of risk management. We do not want to be prescriptive, however would be cautious of a paper based risk

	implement a risk management system through a software system – this also aid the fund when reporting to clients and regulators, as risk and other reports can be quickly and easily created.	management system.
	6 RISK MANAGEMENT **Refer to Annexures B1, B2 and C for the detailed views as developed by the industry work group.**	The annexures are appreciated and will be considered when drafting the regulations.
6.1.1 Capital Requirement:	• The proposed framework does not state what specifically this entails, but if this is a risk-based capital requirement this will have a significant impact on the success of this hedge fund category, as hedge funds of this category will surely be discouraged by this requirement.	Similar capital requirements as for the traditional collective investment schemes will be required. Capital requirements are one of the cornerstones of regulations as they assist in maintaining the financial soundness of a financial entity.
	• Details of the methodology to be used in this instance are required in order to comment fairly and substantially on this point/proposal in detail.	Noted, will be provided in the proposed regulations.
	• The Collective Investment Scheme (CIS) management company is subject to a Capital Adequacy Requirement (CAR) of 52 weeks of expenses. We propose that any additional CAR for Hedge Funds should take this into account. For example, the management company may be required to hold an additional CAR being a percentage of hedge fund assets under management.	Noted, will be considered as part of the proposed regulations.
	• This section deals only with the requirements for Retail funds and Retail fund managers, with reference to Section 88 of CISCA. (Section 88 does not however provide any significant detail in numbers as to what the requirements are). These prudential requirements will result in additional capital that will further incentivise managers from providing product and thus having a negative impact on growth. There is no mention of Prudential	Noted. Prudential requirements will be applicable to both types of hedge funds, but at varying degrees to reflect the different natures of the two hedge funds and the objectives of regulating them.

	Requirements for Restricted funds. Existing managers under Category IIA are subject to these requirements. Where a fund manager is to retain their IIA "license", one assumes that CISCA requirements would be in addition to the existing FAIS requirements. This needs clarification.	
	• Further guidance is required as to registration and capital requirements for managers of CIS in hedge funds.	Noted. The detail in this regard will be considered when the regulations are drafted. The regulations will provide greater clarity.
6.1.2 Funding of Excess Capital Requirements by Manager	This requirement will damper the objective of and manner in which hedge funds function and operate. This requirement will surely impact the success or attractiveness of this category of funds for potential fund managers. Although this requirement will decrease the risk exposure to investors of this fund category, it will also damper the effectiveness/attractiveness of this category to investors as this will impact the manner in which hedge funds conduct their business and could ultimately directly lead to decreased performance.	The regulators intention is for investor protection by limiting the investor's liability to the value of his investment, especially for investors in a RH. The questions of shortfall where the fund had a leveraged exposure greater than its NAV for example will be the subject of a contractual arrangement between the manager and its chosen service provider. It is also important to note that the proposed regulations, especially for a QIHF, will not limit at all any of the various strategies available to hedge funds managers. These strategies are what set apart hedge funds from other pooling investment vehicles.
	• We note that within a Limited Liability Partnership (LLP) structure the General Partner takes on the liability but within the proposed Retail Hedge Fund it appears that the Management Company owner is responsible for this potential excess loss.	Correct. See Above
	• What additional/excess requirements would a manager have to fund? In order to understand this, we would require a working example.	The purpose of this provision as stated above is to ensure that the investor's liability is limited therefore an investor should not lose more than the value of his investment. Any excess loss would have to be carried by the manager. It is this excess loss that reference is being made.
	• The hedge fund structure already provides for limited	We have considered this provision for deletion.

	liability. A manager set up as a limited liability entity, would be incentivized not to maintain anything above the prescribed minimum capital adequacy of R3mil in the entity. Depending on the assets under management, the assets to claim from the manager would not fill the gap. So very little would be achieved. *The risk of operating a retail hedge fund will be too onerous to bear, forcing current businesses to close shop.*	
	• This requirement is extremely prejudicial to smaller fund managers. We suggest that this requirement is removed and replaced by the use of a prescribed insolvency remote vehicle approved by the FSB. Fund managers generally act by virtue of a mandate which meets the regulatory requirements. It is however essential that the fund is bound by all trades entered by the fund manager	We are of the view that segregating the assets and limiting the loss is a better solution. CISCA contains provisions to address the segregation and identification of assets. If there is a failure, liability is limited to the respective portfolio.
	Housing within CISCA should be structured so as to limit losses to the fund. There should be no recourse against the portfolios for losses in excess of the portfolio NAV. This will also facilitate appropriate credit extension by counterparties.	Correct, CISCA contains provisions to address the segregation and identification of assets. If there is a failure, liability is limited to the respective portfolio
6.2.1 Policies and Procedures:	I would recommend that the word 'written' be added to this point, as numerous boutique businesses state that they have written policies and procedures (even when stating that they have). These written policies and procedures should be filed and be available if investors or auditors require them – this forms part of best practice due diligence.	Agreed. It will be the responsibility of the board of the QIHF and the Manco for the RF to have written policies and procedures.
	Highly recommended: Hedge fund best practice would dictate that funds have a written document containing their investment process.	Agreed.
	• It is unclear as to whether these policies extend to personal account trading? We would recommend that personal account trading is captured here.	Agreed – this should be provided for under the FAIS Act, as the trading will ordinarily be undertaken by the investment manager. However we acknowledge this comment as a point for further consideration.

	6.2.2 The conduct requirements should not be regulated by the Registrar of Collective Investment Schemes as these criteria do no relate to structure of the vehicle but the management which are comprehensively regulated in terms of FAIS.	In terms of regulations the conduct of the MANCO and the Board of Directors will be monitored under CISCA, while the conduct of the investment manager will be regulated under the FAIS Act.
6.3.1 Independent Valuation of Assets:	Normally the independent valuation of assets are done by the fund administrator – will fund administrators qualify under this point?	Yes, as long as the fund administrator is independent.
	We request clarity with respect to the "independent valuation of assets". Specifically whether this allows for arm's length independent valuation provided internally within the Hedge Fund, coupled with periodic oversight from external auditors. Limiting to independent external valuation would strengthen the valuation process but affording for internal arms-length framework may be considered as an economically efficient alternative.	No, we will not permit independent valuation internally; external 3rd party independent valuation will be required.
	• This paragraph states that all fund managers must submit to an "independent valuation of assets of the hedge fund". This is common practice in the existing environment and currently performed predominantly by Administrators. Administrators are however not currently regulated service providers. There is also no clarity as to who or what parties may be considered as independent, who appoints the independent party, what processes are required to ensure absence of conflict of interest in their appointment, whether they have the requisite competencies and whether or not they are required to be regulated under FAIS, Banks Act, etc. or a member of an appropriate professional body such as SAICA.	We are mindful of the fact that fund administrators are not currently registered under FAIS Act. It is envisaged that a regulatory structure will be created for fund administrators by the time the regulations come into force.
	• Clarity is required as to:	Valuation must be equal to dealing period, i.e. weekly funds must be

	○ the frequency of the independent valuation; and ○ who would be considered independent.	valued at least weekly. Regulations will be more specific.
6.3.2 Daily pricing Availability:	• Question: Will the hedge fund be required to make this daily pricing available? If so, though which medium and mechanism?	RFs will have to publish soft NAV's on a daily basis on the fund's website and in national newspapers.
	• Question: Will the hedge fund be required to report these pricings to the regulator? If so, on what frequency?	No, but the regulator will require this information in the quarterly reports.
	• We refer to our comments relating to 2.3 and 2.5 above and our general comments and concerns. Many smaller funds only provide monthly pricing and monthly liquidity. The additional costs of providing daily prices and 14 day liquidity will be detrimental and once again cause smaller hedge fund managers to close their businesses and their funds.	There are adequate provisions to deal with smaller hedge funds. We note the concern regarding daily pricing and will amend to provide that the pricing must be equal to the dealing period, but daily funds will be required to price daily.
	• The benefit of daily pricing would be to increase transparency and mitigate the risk of artificially low reported fund volatility. A potential risk to this however is that it may imply the ability to deal on a daily basis. A further risk is potential investor dissatisfaction arising from prices between dealing dates not being consistently reflective of the prices on dealing dates. We propose that the daily pricing requirement be relaxed and more closely aligned with dealing dates and that there be a differentiation in pricing frequency between Retail Hedge Funds and Restricted Hedge Funds ("Institutional Hedge Funds"). We propose that Retail Hedge Funds be required to provide pricing on a more frequent basis than Restricted Hedge Funds based on the higher liquidity requirements but should not	Agree, frequency of pricing will be equal to the dealing period.

	necessarily be subject to the daily pricing requirement of a traditional CIS.	
	• 6.3.2 and 6.4.1 Providing daily soft pricing is possible. This should not be tradable however. An investor with a significant percentage interest in a fund would prejudice remaining investors should he withdraw on short notice. He would force the manager to liquidate in short time, depressing the values of assets to the detriment of remaining investors. Provision must be made for a redemption gate to protect remaining investors. Fund must allow manager to charge entry/exit fees (to the credit of the fund) in order to pay transaction costs which would otherwise accrue against remaining investors.	Noted. We agree that soft pricing will be permissible however this should not be traded. In respect of gating provisions the specific requirements are still under consideration. We note that a provision for redemption gates is important. There are similar provisions under CISCA which will be reviewed in the context of hedge funds. We would proposed that no gating provision is specified in the regulations for QIHF, but the manager must disclose this upfront to investors where it exists. Entry and exit fees can be applied and they must be in the deed.
	• *These requirements are impractical for existing hedge funds*	Concerns have been noted and changes have been made where applicable. Based on our engagements with stakeholders it does not seem that these requirements are impractical.
	• Daily soft pricing will be possible for most funds, but it should not be tradable.	Agreed.
	• It is stated that trustees approve the valuation methodology for unlisted instruments. Without more prescriptive guidelines in this respect, subjectivity would introduce inconsistencies across the industry. The separation of listed, now Clause 6.3.3, from unlisted, by the inclusion of an additional section:	We do not want to prescribe a methodology. The Manco will be responsible for establishing a valuation methodology with the trustees for the RF and the board of directors for the QIHF, which must be based on the IOSCO principles of valuations of hedge funds. Methodology must be established beforehand.
	"6.3.4 – The unlisted investments must be priced based on a generally recognised methodology and by a person	The requirement in this respect will be similar to the provisions of BN 80 of 2012, which in a nutshell states that "If any unlisted securities

	acceptable to the Trustee, subject to the requirements of the Act" We do not believe that it is appropriate for the trustee to approve the methodology. S70 of the Collective Investments Schemes Control Act ("Act") governs the duties of the trustee and does not lend itself to the trustee performing a duty other than review, enquire and report on the administration of the scheme. Pricing of an instrument forms part of the administration of the scheme. Administration is defined in the Act as follows: "administration" means any function performed in connection with a collective investment scheme including (a) the management or control of a collective investment scheme; (b) the receipt, payment or investment of money or other assets, including income accruals, in respect of a collective investment scheme; (c) the sale, repurchase, issue or cancellation of a participatory interest in a collective investment scheme and the giving of advice or disclosure of information on any of those matters to investors or potential investors; and (d) the buying and selling of assets or the handing over thereof to a trustee or custodian for safe custody; S70 (10(f) of the Act states: A trustee must enquire into and prepare a report on the administration of the collective investment scheme by the manager during each annual accounting period, in which it must be stated whether the collective investment scheme has been administered in accordance with (i) the limitations imposed on the investment and borrowing powers of the manager by this Act; and	are included in a portfolio they must be valued daily based on a generally recognised methodology and by a person acceptable to the trustee…. The trustee is not required to approve the methodology on the person conducting the valuation. The methodology to be used must be a generally recognised one.

	(ii) the provisions of this Act and the deed; • As for the unlisted the wording it is suggested that it is the same in Board Notice 80 under CISCA. The Act does not provide any room for the trustee to get involved in prescribing any policy or methodology, as the independence of the trustee function may be impaired. In the EU regions, under UCITS 4 and Guidance 1/100, it requires a trustee to ensure that the value of units is calculated in accordance with the Regulations and / or the trust deed, deed of constitution, articles of association or partnership agreement, as appropriate. The trustee should ensure that the valuation methodologies provided for in the constitutional documentation are adhered to and the operations of the management company are properly controlled.	
	• We are concerned whether existing trustees have the appropriate skills to fulfil this role. We suggest that large institutions with independent risk departments or specialized risk service providers would be better equipped. These we suggest that these "trustees" should be subject to a registration process. We suggest that the valuation process should be aligned with well-established market norms prescribed by the prudential regulator. It is not practical to value certain instruments on a daily basis.	There is no requirement that the existing trustees should act as trustees of hedge funds. Any company meeting the requirements of CISCA can register as a trustee. An acceptable methodology proposed by the trustee can be considered, however it need not be the only methodology used. The methodology used should however not differ markedly from the agreed upon methodology.
	• 6.3.3 The pricing of the listed vs unlisted investments should ideally be dealt with in two separate sentences. I also suggest the following wording for a separate sentence numbered 6.3.4 for the valuation of unlisted investments: "6.3.4 – The unlisted investments must be priced based on a generally recognised methodology and by a person acceptable to the Trustee, subject to the requirements of	The trustee's role will be to review in terms of their oversight responsibilities. Trustees will not prescribe but approve the methodology. We will consider a methodology that is generally agreed upon, but will not restrict it to any one methodology.

	the Act" We do not want the trustee to approve the methodology. My motivation for this suggestion is as follows: The IOSCO 2012 Consultation Report on "Principles for the Valuation of Collective Investment Schemes" seeks to modernize principles for CIS valuation, given hard-to-value or mark-to-model securities that are included in portfolios. Principle 10 in particular, deals with disclosure to investors on valuation policies and practices and the treatment of non-traded prices. Our reading of these principles suggests that a dealing price made available less frequently per prospectus disclosure or determined by regulation for retail funds, need not preclude a 'soft NAV' from being published as a fair value or indicative price.	A soft NAV (Net Asset Value) will be acceptable. Where there is a daily dealing period however a hard NAV must be used for trading purposes. The disclosure of the soft NAV will be permitted but only where it has been independently calculated.
6.4 LIQIDITY	**Refer to Annexure C for the detailed views as developed by the industry work group.**	The views are noted and will be considered when drafting the regulations.
	6.4.1 14 Days Liquidity requirement: This will imply that administrators will need to be able to process units on any given day.	Agreed.
	Some administrators may not have the systems to place and handle daily flows. Substantial development costs may need to be incurred. These costs will be passed on to investors.	Noted
	Liquidity should not be an issue for investors in hedge funds. 14 day requirement not necessary. Investors could be required to give 30 days' notice and thus flows can be processed monthly.	Agreed.
	The period of 14 days is inappropriate. It is recommended to be changed to 30 days. The reason is due to the manner in which hedge funds operate – an insufficient or inappropriate	The regulators have considered the 14 day period for RF and have agreed to a 30 day max liquidity period, which is in line with current practice. This 30 period includes the notice period, i.e. all RF must be

	period that is too short will hamper HFs from providing investors with optimal and efficient service and performance. Basically, it will destroy the 'creativity' or 'mandate' that HFs have, which is the reason of their existence. A 14 day period is binding hedge funds too close / similar to mutual funds, while it is assumed that creating this category of hedge funds (retail) is for the purpose of finding middle ground between mutual funds and hedge funds. Although this category is being created in order to protect retail investors …., hedge funds do require some degree of space to work within. Some hedge fund strategies require a certain amount of time, and for these strategies to be worthwhile for hedge funds themselves they require that investors invest for a certain period of time – 14 days is too short, especially if one considers that hedge funds work on a redemption frequency and redemption notification period. Thus, it will effectively mean that certain hedge funds will not be affordable to the retail investor – which is part of the aim of this liquidation period. Globally a great number of hedge funds have a 30 day redemption period in addition to the redemption notification period (from 10 – 30 days). The liquidation period criteria for this category of funds will ultimately make some hedge fund strategies inappropriate for this category – which I gather might be the idea. The strategies that should be excluded from the retail fund category would include amongst others; distressed debt funds, macro funds, short bias funds.	able to get in or out of the fund within 30 days. In respect of QIHF, we propose a 90 day period, this includes the notice period.
	We refer to our comments relating to 2.3 and 2.5 above and our general comments and concerns. Many smaller funds only provide monthly pricing and monthly liquidity. The additional costs of providing daily prices and 14 day liquidity will be detrimental and once again cause smaller hedge fund managers to close their businesses and their funds.	Noted, please see comments above.

	The liquidity requirement is unclear. Daily dealing, with a notice period no longer than 14 days, would give the investor the most flexibility but would create operational complexity for the fund. Fortnightly dealing, with a notice period no longer than four weeks, would allow the manager to bulk sales and redemptions into two clear dealing points per month.	Noted, please see comments above.
	Proposes a maximum liquidity requirement for retail funds of 14 days. We would argue that the management of this is incredibly onerous and it would be preferable to require the fund to allow redemptions on the 15th and 30th of each month instead thereby facilitating the 14 day liquidity but just on pre-defined days.	Noted, based on comments we propose a maximum 30 day liquidity period. The proposal made would also be acceptable.
	As most Hedge Funds have a 30 day liquidity clause with potentially a 30 day notice period, we propose that the current timeframe to be amended in line with what currently Hedge Funds do, our recommendation being 30 days rather than the proposed 14 days. Also, there are no provisions as to how the investment should be given back to the underlying investor, we require clarity. Given that there is no mention of liquidity requirements in respect of restricted funds, it is implied that there are none. Would this be a correct assumption?	Please see above regarding the liquidity period. In respect of QIHF we propose 90 day liquidity inclusive of the notice period.
	• The proposed framework is not clear whether the "14 day liquidity requirement" implies that there must be a minimum of 2 dealing dates per month, or whether the 14 days in effect becomes the notification period (that would enable the hedge fund manager to ensure sufficient liquidity) implying that daily pricing and daily dealing are required. Under the first scenario where there will be a minimum of 2 dealing dates per month, e.g. in the middle of the month	We do not want to depart too much from current practice. Hence, we are now proposing a 30 day liquidity period inclusive of the notice period in respect of RF. QIHF will have a 90 day liquidity period. This will reflect a balanced tiered regulatory approach between non-Hedge Funds type CISs (requires 14 day liquidity), RHs (30 day liquidity) and QIHFs (90 day liquidity).

	and at the end of the month, it should be clarified what notification period will be allowed/required. For example if investors give notice between day 1 and day 13 it will be honoured on dealing date on day 14 – this would mean that a worst case scenario for the manager is only 1 days' notice. If notice is given between day 14 and day 29 this will be honoured on dealing date on day 30, etc. o The second scenario i.e. where a notice period of 14 days is the legal requirement would mean that retail hedge funds will need to be priced daily and accommodate daily investor dealing. We believe that this would limit some of the investment opportunities that retail hedge funds may invest in, and this practice will also be a major departure from current practice, which is monthly subscription and redemption.	
	• Retail hedge funds should have a maximum fourteen (14) day liquidity requirement as an obligation to investors, similar to the provisions for a collective investment scheme in securities as provided at paragraph 2 of Schedule 1 to the Act. This is to be incorporated in the founding documents as well as the subordinate legislation (i.e. an investor should be able to liquidate his investment within 14 days). *These requirements are impractical for existing hedge funds. Systems and fund strategies are not oriented towards continuous investments/ disinvestments. From the perspective on an investor we do not think this is necessary. We suggest that even for retail hedge funds month end liquidity is appropriate for long term investments. The impact on administration and performance will outweigh the benefit to investors. It is not clear whether the proposal is a rolling liquidity or every 14 days. (RMB & FNB)*	Please see comments above.

	• Momentum Managed Account Platform is a sort of risk management plan to offer hedge fund investors greater protection by segregating investors' assets from the hedge fund manager. I think this is a significant move forward towards giving investors greater confidence that hedge funds are operating within their mandates. Question: Are you planning to encourage all registered Hedge Fund Managers to register with MAP for more comfort on investors' side?	MAP can fulfil specific role, but FSB will not require hedge funds to use it. However, the principle of segregation is an important one and will be applied in both types of hedge funds.
	• The 14 days liquidity should be altered to 30 days. The fund should also be able to have special arrangements in the case of an investor who wishes to liquidate more than 5% of the total funds value as a withdrawal of such magnitude may have significant effect on the fund where the manager is forced to liquidate certain derivatives that can have a substantial negative effect on the whole fund and disadvantage the remaining investors.	Please see comment above regarding liquidity and gating. We will provide for restrictions on redemptions.
6.5 Segregation	• The terms **Trustee** and ***Custodian*** are used interchangeably "depending on the structure of the collective investment scheme" in section 68 of the CISCA. There is no distinction based on the role/duties of a trustee or custodian nor can any particular duty be said to be attributed to one and not the other. In practice a **custodial service** is often part of a broader range of services provided by prime brokers, based on their preferred custodian, which often is interlinked with current operating practices and integration with information systems. The key role of the custodian is the safekeeping of the assets of the fund and the segregation of such assets from other entities. The **focus of the trustee** is more of fiduciary nature, with oversight of the fund based on eligible assets, risk management and other key	RF will require a trustee as per current Manco structure. The custodian will be responsible for the safekeeping of assets subject to segregation as provided for in both CISCA and the Financial Markets Act. The trustee will have a fiduciary role. QIHF will not have a trustee however the board of directors (governance structure) will have fiduciary responsibilities.

	activities and parameters. Any attempt separate the responsibilities/duties between the role of a trustee and custodian needs to first eliminate any confusion caused by the current CISCA usage. These roles also need to be distinguished from the function of a "Nominee" in FAIS. IDS have done some research regarding the roles and responsibilities of trustees and custodians within a global context. This is attached as Annexure B. ***(See also IDS' documents Annexure B)***	
	• **Trustee and Custodian role vis-à-vis Prime Brokers** The Committee is of the view that the industry should be able to comply with the envisaged role of trustees and custodians as described in paragraph 8 of the proposal. Regardless of the legal structure currently housing hedge fund portfolios, the role of a custodian and trustee as set out in Part IX of CISCA should form part of the regulated framework for retail and restricted access hedge funds.	Noted.
	a. <u>Custodian</u> A custodial service is currently often bundled with a range of services provided by the prime broker. The custodian could therefore be the preferred custodian of the prime broker to allow for current operating practices, subject to the registration requirements of the FSB, per paragraph 69 of CISCA. The key duty of a custodian is the safekeeping of the assets of the fund / scheme, ensuring the segregation of the assets of the fund / scheme from other counterparties. A distinction must be made between safe-keeping duties relating to financial instruments which can be held in custody and	We recommend that prime brokers and custodians be separate. The custodian will not be prescribed but both RF and QIHF funds will need to have their assets segregated at the custodian level, even where a prime broker is used. The custodian will be responsible for safe keeping of the assets and segregation of the assets, and ensure (together with the trustee or governing body in the case of a QIHF) that there is compliance with the segregation provisions in the Financial Markets Act and CISCA. The QF will not need a trustee, but will have a board of directors who will fulfil the fiduciary role. If a QIHF manager who also operates a RF, then s/he will also require a trustee to fulfil the fiduciary duty.

	those relating to other assets. For example:	
	• **Assets that can be registered and / or physically delivered, such as transferable securities, money market instruments**. These assets should be held in custody within a segregated account clearly identified as belonging to the fund / scheme, so that they can at all times be clearly identified (see role of trustee below).	The principles of segregation and identification of assets provided for in CISCA will be applicable. This is consistent with the requirements in the FMA.
	For all other assets (such a nominative instruments, financial contracts, assets subject to ending / repurchase agreements), safe keeping is limited to verifying legal and economic ownership and maintaining a register of the assets for the fund / scheme. The assessment of ownership will be based on information and documentation (e.g. ISDA agreement) received from relevant parties, or any external evidence and record keeping the custodian can rely on for purposes of audit.	In order to simplify the model the PB and custodian can be in the same group but separate legal entities, for example RMB PB and FNB custodian where FNB is a regulated and authorised custodian. However, a prime broker cannot also be a custodian. The custodian is however responsible for making sure of segregation of assets at the hedge fund / scheme level.
	b. <u>Trustee</u> While the term may be construed as a role pertaining to a trust structure, its broader use as a fiduciary is what is envisaged. However, the legal ownership of the assets by the trustee as is the requirement for CIS in securities, needs to be discussed with reference to structures other than trusts. While paragraph 70 of CISCA does not distinguish between the role and functions of a custodian versus a trustee, it stands to reason that the balance of functionality in CISCA described in (a) above, would fall to the trustee. We are aware that the FSB is looking into the basis for defining these terms separately within the Act.	Noted, it is our view that contracts should still be kept by custodian – This matter is still under consideration.

6.5.1 Segregation of Assets:	• Agree – the assets of the funds should be separate, distinct and easily identifiable from the assets of the manager.	Agreed, covered under both the FMA and CISCA.
	• The terms trustee and custodian are not defined in any detail (No referenced to any Acts). In the existing environment, depending on the relevant Prime Broker's legal entity type, custody may be managed by the Prime Broker, being segregated at CSDP level, or at the broker nominee level within the JSE's BDA system and Strate.	It will resort under CISCA. There will be a requirement for segregation of client assets at fund level. As responded to above, we recommend a separation between prime brokers and custodians.
	• In terms of the requirement that assets are to be kept in a separate trust account – the confusion around Circular 17 re. Sections 104 and 105 needs to be clarified.	Agreed.
	• The assets of the fund should be separate and distinct from the assets of the manager. A trustee or custodian will be appointed to perform this function. A trustee or fiduciary must be appointed to perform the functions prescribed in the Act and to ensure mandate compliance.	Agreed and done.
	• Momentum Managed Account Platform is a sort of risk management plan to offer hedge fund investors greater protection by segregating investors' assets from the hedge fund manager. I think this is a significant move forward towards giving investors greater confidence that hedge funds are operating within their mandates. Question: Are you planning to encourage all registered Hedge Fund Managers to register with MAP for more comfort on investors' side?	Agreed on the important role of segregating funds and MMAP Also the PB account must be segregated at fund or scheme level at the custodian level. No, we will not require registration with MMAP, as this will create a captured market for MMAP
6.5.2	• In the existing environment, operational trust accounts are opened and operated by the hedge fund's appointed Administrator. This paragraph	The operational trust accounts for QIHF can remain with the fund Administrator controlled by the board of directors, but the RF funds under the Manco structure will have to move to a trustee (model).

	suggests that this function for cash will move to the trustee or custodian. Per above, neither of these providers are defined in any detail in the proposed framework document.	
6.5.3	• It is unclear when reference is made to the 'collateral received', who this is received by. Should this be the Fund Manager, the Fund or the Prime Broker? With regards to collateral being excluded from the NAV calculation, is the collateral excluded from the NAV calculation to avoid double counting? Clarity is required here.	Where the fund receives collateral against OTC derivatives exposure from counterparty, the fund must ensure that this is not included in the NAV as this will result in double counting.
	• This proposal does not make sense as collateral held by a fund can be netted against the funds obligations.	The purpose is to prevent double counting.
6.6 Risk Management Programme:	It should be considered that the risk management programme not only detail derivatives, but also counterparty risk (credit derivatives) used by the hedge fund. Counterparty credit risk is at the forefront in terms of risk exposures and it should be considered that details of these exposures and how these exposures will be managed be included in the information that is to be provided. I notice that counterparty risk is detailed as a maximum of 20% of NAV under point 6.7.5 – but maybe the counterparty risk requirement must be added to the risk management programme as well.	Risk management should include (what?) for listed and unlisted securities, and should further include other risks such as counterparty, operational, liquidity, mandate compliance, stress testing, scenario analysis and market risk.
Risk Management Programme (RMP):	• The use of a RMP should not only be required for retail hedge funds, but also for restricted hedge funds as well – it is good business practice and reinforces the importance of risk management in hedge funds.	The PB model will not be changed as long as there is legal separation of assets. The legally segregated assets will not form part of the 20% limit. Agreed, a RMP will be required for the both the RF and QIHF.
	• 10.3.4.4 refers to the relationships with financial	Noted.

	institutions which could pose systemic risk – however this clause falls under a section dealing with retail hedge funds only. Our recommendation is that this should be expanded to include "restricted hedge funds" as well, as these funds are also exposed to similar counterparty risks which would impact systemic risk.	
	• In the Definitions section, the RMP is mentioned only in the context of risk exposure through a transaction in a financial instrument "not listed on an exchange". In our opinion the proposed RMP should cover a far greater scope of investment risks (not only those relating to unlisted instruments). The RMP should endeavour to be a comprehensive "road map" clearly indicating all the risks that a particular portfolio will be exposed to, and the risk management measures taken by the fund manager to mitigate these risks: - Governance and organisation of the risk management process, including the responsible personnel and their qualifications (e.g. responsibilities of the Manco, the Trustee, the Investment Manager/Hedge Fund FSP, details of outsourced functions, etc.) - Identification and measurement of risks relevant to the scheme (i.e. what are the mandate limits/investment guidelines of the portfolio, including the risk and return objectives of the portfolio; sources of information used for the risk measurement process; stress testing) Management of risks relevant to the scheme (i.e. details on the avoidance or mitigation of risk, including market risk, liquidity risk, counterparty risk, interest rate risk, etc.) - Monitoring and reporting procedures (clear accountability and escalation procedures when risk events happen, remedial policy, etc.)	Agree.

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6.7 (and 3.5) Leverage:

Different interpretation of leverage

Leverage incorporates any investment strategy that increases the effective exposure to a financial instrument beyond the capital employed to enter the position. This may include gearing (=borrowing of cash), using derivatives (effective exposure is greater than the derivative premium/price/market value) or borrowing scrip for short selling. Leverage at a fund level is usually measured as the gross exposure divided by the net asset value or capital.

Long position = holding a positive amount of a financial instrument.

Short position = holding a negative amount of a financial instrument.

Net exposure = sum of all effective exposures obtained through all longs and shorts.

There are different ways in which leverage in a hedge fund is calculated and interpreted.

The best way to illustrate these different methodologies is by way of an example:

EXAMPLE:

*Hedge Fund A has **$1 million of capital**, borrows $250,000, and invests the full $1,250,000 million in a portfolio of stocks (i.e., long $1.25 million). At the same time, Hedge Fund A sells short $750,000 of stocks.*

In the above scenario,

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Our aim is to cover the gross market exposure, where we take into account both long, leveraged longs and shorts, either in a physical or derivatives format.

The total exposure of the fund to the market.

Example is noted and very useful

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	Longs = $1,250,000 Shorts = $750,000 Thus the gross exposure = $1,250,000 + $750,000 = $ 2,000,000 Net exposure = $1,250,000 - $750,000 = $ 500,000 Illustrating 3 different interpretations of "leverage": (i) Leverage = gross exposure/capital to get a leverage ratio of $2,000,000 / $1,000,000 = 200% OR (ii) net exposure as a measure of leverage i.e. because the net exposure is less than 100% ($500,000 / $1,000,000) there is NO leverage OR (iii) "gross market exposure – 100%" which in the above scenario would give leverage of 100% or 1x capital, which can be interpreted as the sum of the borrowings i.e. the $250,000 cash borrowed plus the R750,000 borrowed to sell short. • ***Refer to Annexure E for the detailed view as developed by the industry work group.***	
6.7 Leverage – Illiquid Assets:	• Due to the lack of liquidity for certain financial derivatives/securities in the South African market, special care should be taken as to how the leverage requirements are drafted – particularly if certain financial securities are to be approved or disallowed for use as leverage.	Leverage limit will only apply to RF, and is even likely to be a higher limit than the current one for non-HF CIS. The QIHF must set its own leverage limit and disclose that to investors.
	• Appears to be contradictory. On the one hand it expressly notes the gearing or leverage ability of hedge funds but on the other (in 6.7.2) it seems to say that no gearing is permitted. In addition, the wording in 6.7.3 is unclear. On our reading, gearing of 100% is not equivalent to gross assets being double net assets. We note that UCITS	Gearing, for both RF and QIHF will be permitted. 200% gross exposure permitted for RF, where this is not appropriate the fund can use the VAR limits. VAR parameters to be specified in the regulations. QHIF will not be subject to these limits, but will be required to set its own limit and disclose this to the investors

	permits a gearing of 2 and assume that that was the intention in this case.	
	• We wish to highlight our concerns about the use of VAR as a risk measurement tool. In particular we note: ○ There are a number of ways in which VAR can be calculated and there is significant risk related to the model and assumptions used. ○ Specifying VAR as a risk measure lends itself to being used as a marketing tool with the risk of potential misspelling. This is largely because VAR is not completely objective and can be subject to manipulation. We propose: ○ A limit on total leverage employed in conjunction with the use of the VAR measure. This will provide an additional safeguard in the risk management process. ○ That the regulator lay down a set of principals governing the calculation and use of VAR in the risk management framework. ○ The reporting of VAR and use as a marketing tool is subject to minimum disclosure requirements highlighting the limitations of the measure.	We acknowledge that VaR on its own is not a sufficient indicator of risk and we will look at other measures such as stress testing, liquidity measures, scenario analysis, etc. Parameters for calculating VaR will be prescribed in the regulations. A reasonable leverage limit will be set for RF, while a QIHF will be required to set its own limit and disclose it to the investors.
6.7.1 – 6.7.3	• Information set out in these paragraphs appears to be predominantly in the context of equity portfolios, and may not be wholly applicable (viable) for alternate asset classes such as Fixed Income hedge funds.	QIHF will set its own limits. VaR will only apply to RF. Funds such as fixed income hedge fund,s for example which do not necessarily fall within the 200% gross exposure limit can use a VAR model to enable it to achieve gearing in the fund.
	• Question: The total exposure referred to, is it the Gross Exposure which is total longs plus absolute values of shorts? Can the Hedge Fund managers use the net exposure to determine or indicate their leverage? I am asking this because my concern is that there are no	We will provide a definition of leverage. Definition includes gross exposure.

	standard set of rules or definitions being used in the industry. The standard set of definitions or interpretations can help easy investor understanding. This would also help us, the CIS Department, to monitor different portfolios effectively.	The regulators accept that leverage on its own is not an indication of risk and therefore funds will also be required to test liquidity risk, scenario analysis and stress test the portfolio.
	• Question: is the limit on net exposure (total longs less absolute values of shorts) going to be considered? I am asking this because an unlevered fund can be as risky, depending on the riskiness of its assets in the fund.	We accept that an unlevered fund can also be risky. The definition of leverage will be provided that will address the concern.
	• Question: Do we measure the leverage of 100% or 200%. I am confused by point 6.7.3 above because according to my understanding of leverage if it is 100% it means there is no leverage but if it is 200% it is double of the assets referred to in 1.1.3 above? This can be confusing to investors as well as the hedge fund managers, hence the standard definitions would assist.	Please see comments above. This will be clarified in regulations.
6.7.2	• Include "instantaneous" to "fund's total exposure" in order to incorporate non-linear strategies (optionality).	It is recommended that VaR may be a better measure for funds using derivatives.
	• This requires further clarity as to how the leverage is calculated, for example, Derivatives exposure = 1 x NAV?	Please see above.
	It is not clear whether this net value include the marked to market value of derivatives. If interpreted literally this is impossible.	Please see above.
6.7.3	• This clause requires further clarity as to how much could a fund that uses VAR gear	The current suggestion is a 20%; 1 month VAR for RFs. This will be defined in more detail. QIHFs will not be subject to these limits.
	These leverage limits will preclude many existing funds including market neutral funds	Please see above.

6.7.4 Measuring of Total Exposure for Sophisticated Strategies:	• It could be considered that sophisticated strategies be allowed to use a sophisticated and approved specific model to measure exposures – this is very much in line with Basel III which allows this practice as an alternative to Value-at-Risk (VaR). (More specifically, Basel III allows sophisticated and approved internal market model approach to calculate the CVA risk capital charge).	At this stage, the regulator is only considering a standard risk evaluation model. Too many models, at this stage, could be complex to monitor by the regulator and comprehend by the investing public.
	• Should be expanded to include required confidence intervals and holding periods and the historical data to be used (amongst other information) in order to be meaningful.	Noted.
	• The terms "simple, complex & sophisticated" are subjective terms, open to wide interpretation depending on one's frame of reference, and should therefore be defined in greater detail. In addition to this, there is reference to "normal market conditions". This phrase is also somewhat open to interpretation, i.e. what is "normal"?	The comments are noted and will be addressed when drafting the regulation.
	• It is not clear what sanctions apply where a Retail Hedge Fund breaches either the gross exposure or VAR limits. It would be sensible that the manager be given a grace period if such a breach was caused inadvertently, for example by an increase of general market volatility, during which time the breach would be addressed. It would be appropriate to consider the reporting requirements including notification of breaches to the Registrar and underlying investors. We agree that Retail Hedge Funds should be subject to leverage limits. However, it needs to be acknowledged that the method elected may not imply	The regulator will distinguish between an active and passive breaches. An active breach will need to be remedied immediately and be reported to the regulator, but a passive breach does not need to be reported but must be remedied immediately. Breaches will be dealt with in a similar manner to breaches in respect of traditional CISs. In that instance the managers are given an opportunity to remedy the breach. Breaches will have to be reported to the registrar. More details to be specified in the regulations.

	similar levels of risk across the approaches allowed. For example it is not evident that the application of a 20% VAR utilising a 500% gearing within a fixed income mandate is a similar or comparable risk to that of an equity long-short fund geared at 200% utilising the commitment method. We request clarification on whether the Hedge Fund manager will be given the discretion to elect either the VAR or commitment approach or whether the approach will be defined broadly for the particular strategy employed. For example the VAR approach could be required for fixed income strategies and the commitment approach for equity strategies. However it is not clear which approach would apply to funds adopting multi-asset class strategies which straddle both. We propose: o The inclusion of short selling limits within the Retail Hedge Funds with specific reference to positions in Small Cap equity counters. o The risk management program should include daily checks against mandate limits. o Service provider credentials should be verified either on a 6 monthly or annual basis. o The manager's definition of gross exposure and VAR should be documented in their risk management process and approved by the Registrar annually.	Noted, this will be considered. Agreed. Agreed, it will be the responsibility of the governing body (ie MANCO in the case of a RF and the Board of Directors for a QIHF) to verify the credit worthiness and credentials of the counterparties and service providers. Agreed, this will be included with the reporting and disclosure requirements.
	• There is a substantial amount of industry critique on the use of VAR as a reliable measure of risk and we are concerned that the use of VAR may lead to excessive risk taking as it underestimates tail risk of an investment strategy. In the proposed framework no period (daily, weekly, monthly, etc.) is specified for the calculation of this risk measure. It is kindly requested that further	We acknowledge that on its own VaR is not a reliable measure of risk. We, therefore, propose daily calculation of VAR, combined with liquidity testing and stress testing of the portfolio for both QIHF and RF.

	refinement of a suitable risk measure is sought in conjunction with any parties whom the regulator deems appropriate, at a near future date.	
	• The rules for measuring total exposure and leverage differ depending on whether the fund uses simple or complex (termed "sophisticated") investment strategies. A fund that uses non-complex investment strategies will generally measure total exposure and leverage according to the commitment approach. A fund that uses more complex or "sophisticated" strategies will employ an advanced risk measurement methodology. The use of the Value at Risk (VaR) method is recommended. VaR is an estimate of the worst possible loss an investment could realise over a specified period under normal market conditions. *Without further defining the VAR parameters it is difficult to assess the effectiveness of this risk measure.*	Noted, this will be clarified in the regulations.
6.7.5 (& 10.3.2) :	• The 20% and 10% limits on counter party exposure are too onerous and not practical in SA. The limits are just not workable as there are too few prime brokers operating locally. *Recommend a minimum of two counter parties with a maximum exposure of 60% to any one such counterparty.*	The 10% limit refers to OTC counterparty risk; this limit can be managed by posting collateral on a bilateral basis from the counterparty to the fund. The 10% limit does not include the notional exposure, but the mark to market (MTM) of the fund and any over collateralised exposure of the fund to the counterparty, like an independent amount. This provision is in line with South Africa's proposed OTC derivatives regulations. If the assets of the hedge funds are segregated at the custodian level then this will not form part of the 20% calculation, but this is still being discussed within the context of the framework.
	• Counterparty exposure should be limited, but where a 20% limit per counterparty is appropriate for large companies it may be too high for others. We propose applying the limits	See above.

	contained in CISCA Notice 80 designed to address these specific issues. This will ensure the limits give adequate consideration to the nature of the proposed counterpart. For example a lower tier bank may have a lower permitted exposure than an upper tier bank.	
	• Our understanding was that this amount was supposed to be 30% rather than the 20% contained in the proposed framework.	See above. The figures are still under discussion, and may change.
	• It is unrealistic to expect funds to use greater than two PB's for the following reasons: Assets Under Management (AUM) are too small. Two PB's would provide necessary counterparty diversification and only 5-6 PB's are operational in the market. Given the limited number of suitable potential counterparties in the local market, 20% exposure limits appear to be low, further clarity needed as to how the 20% counterparty risk exposure is defined and calculated.	The comments are noted and will be taken in account in the draft regulations.
	• Recognized exchanges (exchange listed instruments) must be excluded from counterparty risk.	The comment is not clear to us; for example, whether "recognised exchanges" refers to "internationally" recognised securities exchanges, or that any listed exchange instrument (irrespective of whether the exchange is recognised or not) should be excluded from counterparty risk.
	• We suggest that a clearer distinction between counterpart and credit risk would be useful. Does this 20% for instance include deposits, exchange exposures, collateral placements? The proposed limit is not practical for fixed income funds. This requirement is inconsistent with10.3.2 and Regulation 28.	Comments noted. The purpose of the proposed framework is to propose regulation of hedge funds by the registrar of collective investment schemes. . To the extent that it is practical and appropriate, the regulations may be aligned with other regulatory frameworks.
	• VaR needs more parameters - Confidence Level, Period etc. VaR cannot be just set at a number, the components	Noted, please see comments on VaR above. Agreed, more parameters will be included.

	that make up the VaR calculation need to be more defined. *Recommended include more parameters in the definition of VaR.*	
	• Agree on the degree/level of maximum relative VaR to be allowed.	Noted.
	• Possible future discussions may be warranted concerning the maximum amount of Absolute VaR that is to be allowed.	Noted.
	• We note the reservation around the use of absolute VAR. It would also be useful to have the perceived deficiencies in the approach outlined and whether this metric is to be applied within certain parameters. The Relative VAR approach necessitates an appropriate benchmark. To the extent that the benchmark is not stipulated this may expose the measurement and reporting of risk to manipulation or gaming. To the extent that the manager is given discretion in this regard it should be a requirement to document and report the underlying benchmark to the Registrar on an annual basis.	Noted, where relative VaR is used naturally a benchmark is required. When using relative VaR it is proposed that an independent index compiler is used to establish the benchmark. This aspect will require greater discussion for purposes of the regulations.
	• Paragraph 6.7.6 seems to allow for excessive losses. We suggest that these parameters need to be revisited. A twenty percent VaR limit (as suggested) equates to allowing a fund to lose twenty percent of its value over the holding period defined. If the portfolio remains constant this twenty percent may become a rolling twenty percent. So for example assume a holding period of 10 days; over a month this allows a hedge fund to lose forty percent of the value of the fund based on historical volatility and	Interesting point and noted.

	calculated correlation within the portfolio.	
	• Without further the VAR parameters it is difficult to assess the effectiveness of this risk measure. This methodology may preclude many existing funds including market neutral funds	The VaR parameters will be determined for inclusion in the regulations.
6.9 Compliance Officer & Risk Management Function:	• Having a compliance officer also fulfilling the function of a risk manager is not ideal – ideally a risk management function should be totally segregated from all other functions.	Comments are noted.
	• Alternatively, this could be amended to state that large funds (funds with a certain amount of assets or a certain number of clients) have a compliance officer and a separate risk management officer – this will ensure that the compliance officer and risk manager focus strongly on their own areas and that one or the other is not 'uncooked' due to larger and more complex operations etc.	RF will be required to appoint a compliance officer approved by the Registrar, which compliance officer must have adequate hedge fund experience and knowledge. The function may be outsourced, however the manager will remain responsible and accountable for compliance. The QIHF will not be required to appoint a full time compliance officer, however it must have a compliance function and a risk function. Compliance in this respect will be the responsibility of the governing board.
	• It is not clear in terms of this requirement whether or not the appointed Compliance Officer is required to be in the permanent employ of the fund / fund manager, or if such compliance officer may be appointed on a contractual / outsourced basis as is currently possible for Category IIA fund managers in terms of the FAIS Act. The FAIS Act requires certain levels of qualification and experience of a Compliance Officer, however this document is mute on those points. Further to the above, this section refers to "a risk management function" to be performed by either the compliance officer or a risk manager. Greater definition of this function and the relevant requirements and responsibilities would be most helpful.	Further clarity on the risk and compliance functions will be provided for in the regulations.

	• The conduct requirements should not be regulated by the Registrar of Collective Investment Schemes as these criteria do no relate to structure of the vehicle but the management which are comprehensively regulated in terms of FAIS. We suggest that risk management functions are separated, although the compliance officer should ensure that appropriate arrangements are in place. We suggest that large institutions with independent risk departments or specialized risk service providers are best equipped to monitor market risk.	Noted, suggestions will be considered. The Registrar of CIS supervises conduct of managers (or of Manco?) (CIS) while FAIS supervises the FSP (the investment manager).
7. Transparency and Disclosure :	• **Refer to Annexure D for the detailed view as developed by the industry work group.**	Noted, will be taken into account when drafting regulations.
	• Best practice also dictates that hedge funds disclose their investment process in easily understood terms with additional information possibly to be provided upon request – this is probably very similar to point 7.3, although the explicit use of the phrase 'investment process' might be considered. Please note that investment policy and investment process is not the same.	It is noted that investment policy and process are not the same. The regulations will provide for disclosures to investors and the Registrar.
7.1	• Hedge Fund managers, like other discretionary portfolio managers, are unlikely to want to disclose their specific positions. The ability of managers to deliver will also depend on the timing requirements (as more complex instruments are more difficult and therefore involve a more complex valuation process).	Noted, however this is information which will be disclosed to the Registrar and it will be historic information. The intention is to retain the requirement.
	7.3 • We propose the formulation of the KIID framework should allow for adequate industry consultation and input. This framework should ensure a minimum content requirement	The KIID has been incorporated into the Advertising and Marketing Guidelines for collective investment schemes and has been crafted to allow for use with hedge funds. The guidelines will be revised as

	while affording asset managers appropriate flexibility to differentiate and market their offerings. Due consideration should be given to existing industry marketing standards such as the ASISA Advertising Code.	necessary after the declaration of hedge funds.
	7.4.2 • Risk and reward indicator have not been defined. It is unclear as to how the risk and reward indicator is determined indicating the levels of risk. Is this needed for both restricted and retail funds?	This will be clarified in the draft regulations.,
	Further details are required before this proposal can be assessed	For guidance please see draft notice for marketing and advertising of collective investment schemes.
	7.4.3 • We propose Total Expense Ratio (TER) should be included when presenting the charging structure.	Noted. The intention is to align this with similar requirements across the financial services sector.
7.4.4	• Hedge funds should also consider being CFA Institute compliant in terms of: ○ Soft dollar standards ○ Research objectivity standards ○ Especially - Global Investment Performance Standards (GIPS)	Noted, these will be considered in the drafting of regulations.
	• Even though these CFA Institute standards are voluntary they do add transparency, trust and enhance comparability.	Noted.
	• Past performance of the existing funds should carry the requirement that the performance was independently administered or audited.	The advertising notice for collective investment schemes will be applicable and amended as necessary to allow for application to hedge funds.

	• The requirement for a past performance presentation of the performance of the fund over the last 10 years is understandable, but our concern is that many of these funds would have been operating with different risk parameters and the historical presentation may therefore misrepresent possible future performance. In addition, is it permissible for funds to extrapolate future performance given that this regulation introduces a new retail structure with new parameters?	The advertising notice for collective investment schemes will be applicable and will be amended to the extent necessary to address specific hedge fund issues.
	• This section suggests that the KIID contain performance data for the fund for the last 10 years. In the South African context it must be noted that there are few if any hedge funds that have been in existence for 10 years or longer. For any current hedge fund (which may today be one of many structures e.g. a partnership, or segregated account), when "converting" to a fund under CISCA, can one rely upon the past performance data of that structure? This section deals with new funds and performance data, however from a client experience perspective they would want to determine continuous performance of their existing portfolio. Fees, costs etc. will potentially be different as well as valuation methodologies, so is it sufficient to explain the differences through disclosure?	Noted. It is appreciated that there may be a few hedge funds which have been in existence for 10 years. If it is proposed that the differences are explained to investors in other ways in addition to the disclosure requirements. It is our view that such disclosure will only be fair to customers.
7.4.6 Regulatory Reporting – Counterparties:	• It might be beneficial to include that hedge funds should include their level of exposure to each counterparty, as this will be informational as well as valuable in assessing possible systemic risk.	Agreed. This is precisely what will be required in the reports to the Registrar.
	• I hope that this reporting won't be too onerous. The	The reporting serves to monitor <u>potential</u> (not only actual) systemic

	odds that an industry with assets of approximately R30 billion can impose systematic risk in a R3.5 trillion economy seems implausible. Empirical evidence during the financial crises shows that banks, not hedge funds were the ones who had to be bailed out in order to prevent systemic risk.	risk and to ensure investor protection. Investor protection is important particularly given that pension funds are now explicitly enabled to invest in hedge funds. It is also notable that the hedge fund industry is growing as has been evidenced by the recent statistics.
	• Refers to a requirement for all funds to report monthly.	The reporting requirements have been reconsidered and QIHF will now be required to report more frequently by providing reports quarterly and annually. RFs on the other hand will be required to provide monthly, quarterly and annual reports. The detail on what should be included in each report will be provided in the regulations, however this will include, amongst others, reporting on leverage, counterparties, strategies and derivatives.
	• This seems to contradict the earlier statement (in sub-section 2) that restricted funds are only required to submit annual reports. We would ask that more detail be provided on what information needs to be reported, in what format and at what intervals. (On this point specifically, the JSE MAP system has quite sophisticated reporting ability and we would be more than happy to spend time with you showing you what time of information can be reported and assisting in determining the relevance of the information.) One way of dealing with this is to produce a template for completion and submission by the relevant parties.	The logistics around reporting will be considered, and a reporting template will certainly be provided
	• More detail and definition will be required in terms of this item. In addition, clarity is required as to whom may provide this information / perform this role on the hedge fund / fund manager's behalf, i.e. is it permissible	The report will be submitted by the person holding the CIS licence; it may be outsourced as permitted by CISCA, however an outsourcing arrangement does not mean a manager can abdicate its responsibilities. Reporting will be to both investors and the Registrar,

	to outsource this function, and if yes, to which of the relevant hedge fund financial service providers.	but this item refers to reports to the Registrar.
	• 7.4.6 to 7.4.8 In respect of the regulatory reports required to be submitted by the hedge funds, additional guidance is required in respect of the following: • Whether the reports need to be independently audited? • Content and format of reports? • Reporting deadlines? • AFS reporting requirements and deadlines? • Will IFRS be the required basis of accounting? • Consequences of non-compliance? •Difference between reporting requirements of the manager and that of the fund? •The frequency of the reporting should also be re-considered, as we suggest from a risk management perspective that more regular i.e. quarterly rather than annual returns should be submitted by Hedge Funds.	Further guidance in this respect will be provided for in the regulations. This includes what must be reported and the respective deadlines. Audit reporting is still under discussion. Agreed, more regular reporting will be required. QIHF will have to furnish quarterly and annual reports while RF will be required to also report monthly.
	• Depending on the definition of credit counterpart, this requirement may be particularly onerous, and needs to be carefully considered.	Noted.
7.4.7 and 7.4.8	• Raise essentially the same points as above regarding the level of detail that is required to be reported and the format in which it needs to be reported.	Noted, please see comment above.
8. Prime Brokers	• These entities play a large role in the hedge fund industry than most may think, and are also the origin/additional point for creation of systemic risk. Thus, these entities will have to be regulated and monitored just as hedge funds are – that said, these entities are crucial for the survival and growth of the hedge fund industry, so over-regulation on these entities will hamper their eagerness/willingness	Fair comments and noted. It is not the Registrar's intention at this stage to regulate PBs in respect of their prime brokerage services, as it is understood and accepted that PBs are generally regulated entities whether they are regulated by the SARB as banks or the JSE as pure brokers. A manager will also not be permitted to use the services of a PB that is not regulated.

	for participation which will directly impact the hedge fund industry.	
8.1 :	• Prime Brokers provide more than listed services. By way of example Derivatives (SWAP) are not included or listed. *Recommend expand services provided to include derivatives (swaps).*	Noted.
	• ***Question:*** Will the prime brokers need to register with FAIS Department for their activities, because currently they are not?	As matters currently stand PBs will not be required to register in respect of their activities however this may change at a later stage.
	• The view is that the industry should be able to comply with the envisaged role of trustees and custodians as described in paragraph 8 of the proposal. Regardless of the legal structure currently housing hedge fund portfolios, the role of a custodian and trustee as set out in Part IX of CISCA should form part of the regulated framework for retail and restricted access hedge funds.	Noted, it is however not our intention to require QIHF to appoint a trustee. The Board of the operating entity will be responsible for the fiduciary role.
	Custodian A custodial service is currently often bundled with a range of services provided by the prime broker. The custodian could therefore be the preferred custodian of the prime broker to allow for current operating practices, subject to the registration requirements of the FSB, per paragraph 69 of CISCA. The key duty of a custodian is the safekeeping of the assets of the fund / scheme, ensuring the segregation of the assets of the fund / scheme from other counterparties. A distinction must be made between safe-keeping duties relating to financial instruments which can be held in	Noted, the suggestion is welcomed. Yes, that is the duty of the custodian as we understand it.

	custody and those relating to other assets. For example:	
	• **Assets that can be registered and / or physically delivered, such as transferable securities, money market instruments**. These assets should be held in custody within a segregated account clearly identified as belonging to the fund / scheme, so that they can at all times be clearly identified (see role of trustee below).	
	• **For all other assets (such a nominative instruments, financial contracts, assets subject to ending / repurchase agreements)**, safe keeping is limited to verifying legal and economic ownership and maintaining a register of the assets for the fund / scheme. The assessment of ownership will be based on information and documentation (e.g. ISDA agreement) received from relevant parties, or any external evidence and record keeping the custodian can rely on for purposes of audit.	
	Trustee While the term may be construed as a role pertaining to a trust structure, its broader use as a fiduciary is what is envisaged. However, the legal ownership of the assets by the trustee as is the requirement for CIS in securities, needs to be discussed with reference to structures other than trusts. While paragraph 70 of CISCA does not distinguish between the role and functions of a custodian versus a trustee, it stands to reason that the balance of functionality in CISCA described in (a) above, would fall to the trustee. We are aware that the FSB is looking into the basis for defining these	The terms custodian and trustee are used interchangeably in CISCA. A clear distinction will be made where reference is to a depositary (term has not been agreed on). The trustee performs a fiduciary function and in respect of the QIHF this function will be performed by the Board of Directors of the entity responsible for the affairs of the fund.

	terms separately within the Act.	

	<u>Prime Broker</u>
	Registration and supervision
	
	Services provided by Prime Brokers are a combination of a set of activities **already well-regulated,** and not necessarily uniquely provided by Prime Brokers.
	
	Prudential capital oversight includes that stipulated ito
	• ***Banks***
	  ○ Banks Act 94 of 1990
	• ***Members of JSE Securities Exchange***
	  ○ Security Services Act
	  ○ Financial Markets Control Act 55 of 1989
	Supervisory oversight under the auspices of the
	• JSE (under powers given to in terms of the Financial Services Board Act 1990)
	• South African Reserve Bank
	
	List of activities typically performed by Prime Brokers include
	• Execution of transactions (covered by Security Services Act)
	• Value added services, including asset administration, custody, settlement and clearing
	• Facilitation of scrip lending
	• Counterparty to OTC derivatives
	• Credit intermediation (fixed interest) – all credit exposures of the fund are to the prime broker, and the fund has to only hold collateral with one counterparty.
		Noted.

	All these roles are sufficiently covered by current legislation: • 8.1.1.2 Margin deposits in Broker Dealer Accounts (BDA) are covered by the JSE or alternatively by the FAIS Act regulating discretionary investments • 8.1.1.3 Credit facilities are done through ISDA based OTC transactions and are regulated in terms of instrument and credit limits • 8.1.1.4 Lending activity is governed by the JSE and other legislation	
8.1.1:	• The definition / explanation provided is vague, misleading and incomplete, and should be revisited in consultation with Prime Brokers. As mentioned above, not all Prime Brokers offer all available products and services, and not all clients of Prime Brokers are necessarily Hedge Funds. Legal entity structures, exchange memberships, business strategies and client needs ultimately determine which products and services or combinations thereof are offered and provided.	PBs must either be a bank under the supervision of the SARB or an authorised user in terms of the FMA (regulated by JSE). We appreciate that the PB activities are not regulated but we want to ensure that only a regulated PB is appointed. It does not have to be a Cat I or II FSP, but must for now be an authorised user or a bank. The intention is to only permit regulated entities for this purpose.
	• Fixed Income Prime Brokers trade with and credit enhance fixed income funds. In order to provide this gearing it is essential that they hold assets as collateral.	Noted, this aspect is under consideration and will be catered for in the regulations. While they hold assets as collateral, there will be a restriction with respect to the re-use (rehypothecation) of assets.
8.1.2 Rehypothecation :	• Specific details pertaining to the level of allowed rehypothecation will be required in order to comment fully and fairly on this point/requirement.	Noted.
	• Re-hypothecation is not currently permitted in the hedge fund/prime brokerage structure in South Africa. We argue that this should continue to be the case as it introduces unnecessary systemic risk.	Rehypothecation is restricted because of the nature of the assets held by the PB, however cash and bonds can possibly be used (due to their fungible nature?). We will attempt to address this matter more fully in the regulations, and currently advise that the issue is still under

		consideration.
	• Rehypothecation of assets should be considered with context and consideration of the SSA / Financial Markets Bill (Act). The restriction of rehypothecation is not practical as Prime Brokers take 100% of the assets as security. This should primarily reference activities whereby the Prime Broker will reuse the funds collateral to generate ancillary returns through its on-lending/pledging.	Rehypothecation is being considered in light of the FMA as well as the CISCA requirement for segregation and identification of assets. The role of rehypothecation is still under consideration.
	• In terms of South African law one cannot retain security of collateral if control of the asset is released. To the extent that this may be applicable to foreign funds, these should be restricted funds and therefore not subject to this limit.	Noted, please see comments above.
8.1.3 Registration of Prime Brokers:	This point is of immense importance, especially for large prime brokers like banks, and it would be advisable to prime brokers also report their counterparties and the exposure level to each counterparty (on a monthly basis).	Noted, in respect of the RF we have the manager and the trustee to rely on for such disclosures however this requirement may be worthwhile in respect of the QIHF.
	• The above point is of importance, as prime brokers play such a large role in terms of counterparty credit risk in the hedge fund industry and thus should be accounted for in terms of (possible) systemic risk.	Noted.
	• What constitutes an “approved financial services provider” within this context needs to be defined and more information needs to be provided around how the appropriateness of their risk management systems will be assessed.	An approved FSP is an FSP registered in terms of the FAIS Act, however given that PBs are currently not registered under the FAIS Act, it has been decided that PBs can be either a bank or an authorised user, regulated by the SARB and the JSE, respectively.
	• Aside from Prime Brokers who are regulated under the auspices of the Banks Act, further clarification or definition	Noted, please see comments above regarding PBs. For now there won’t be a requirement for registration of PBs under the FAIS Act.

	should be provided with respect to what constitutes "approved financial services providers". This is out of kilter with the preamble of the proposed regulations stating that Prime Brokers will not be regulated. 8.1.3 and 8.1.5; Banks Prime Brokers are already regulated for these services and it would be redundant and impractical to add another layer of regulation here.	
8.1.4 :	• Prime Brokers at present act as custodians of the fund assets. Recommend Prime Brokers should be able to continue to act as custodians of fund assets.	A PB cannot be a custodian as it is a counterparty in the scheme. Permitting this opens up issues of conflict of interests. However, a custodian can be used which is in the same group of entities as the PB being used. The custodian must be a Central Securities Depositary Participant (CSDP). There must be legal separation of assets (between the custodian, PB and fund). The fundamental principle of segregation and identification of assets applicable to collective investment schemes will apply.
	• We understand the requirement for a degree of separation of responsibilities amongst the various market actors. However, given the relatively small and concentrated nature of the South African market, we assume that it would be acceptable for the prime broker and the custodian to form part of the same group (though not the same entity) e.g. RMB is the prime broker but FirstRand is the custodian or trustee.	Yes. The same group can act as PB and custodian. See also above.
	• Custody of client assets through nominee companies etc. has been an integral part of the Prime Broker offerings to hedge funds historically, providing asset servicing services as well as playing part in the risk management processes of the Prime Broker who typically has a security interest (collateral) in the hedge fund's assets. Certain Prime Brokers who are not registered banks currently utilise their	The comment and provision will be scrutinised further, however the comment would appear to meet our requirements.

	broker nominee companies (JSE participants) to provide a custody framework for the hedge fund's equity assets. With the broker nominee company residing as a client at CSDP level, this is effectively a subcustodian offering which is regulated / controlled under the auspices of the JSE & Strate. Some prime brokers who are registered banks operate with custody accounts held in the name of the hedge fund at CSDP level, whilst others may by means of tri-partite agreements utilise the broker nominee option mentioned above, typically utilizing a JSE participant firm within their group structure. The Prime Broker acts as a defacto custodian/subcustodian. Does the associated custody business meet this requirement?	
	• This proposal is not practical (especially for fixed income funds) where the systems, knowledge and specialized skills are with the prime broker and not the trustees or custodian.	Noted, and will be considered.
8.1.5:	• Banks Prime Brokers are already regulated for these services and it would be redundant and impractical to add another layer of regulation here. There appears to be an inference that an entity offering the services of Prime Broking is (to be) specially registered/licensed for this purpose. This not however the case currently, as (some of) these services are carried out as part of functionality permitted as bank or stock broker. Is it therefore envisaged that Prime broking services per se are to be regulated and if so, how and by which Regulator? The wording of the document seems to indicate so. It specifies that there will be mandatory registration, but by whom? There is reference to FSPs. But Banks and FSPs are regulated differently, so it is not clear what is	We do not agree that prime brokers are regulated for these specific services. This may only be true for banks but not the other prime brokers. However we acknowledge that PBs are regulated entities and therefore no requirements will at this stage be placed on them to be approved FSPs. The Registrar will note the appointment of a PB just as is done with trustees of collective investment schemes.

	intended/proposed i.e. will both banks and FSPs who offer prime broking services be required to follow a new, mandatory registration process under CISCA?	
	It is unclear what is meant by 'supervisory oversight'? Clarity is required.	We require comfort that the PB is a regulated entity that is supervised, whether as a bank by the SARB or stockbroker by the JSE.
8.1.6 Due Diligence In Appointing Prime Broker :	This point is of immense importance. A due diligence process should also be followed for appointing an auditor (point 6.8)	It is expected that the auditor will be appointed in the same manner as they are appointed in respect of a traditional collective investment scheme.
	• As indicated, we would ask that the criteria referred to in this paragraph be defined in order to assess their applicability.	Noted. In terms of due diligence requirements we would expect consideration of whether the PB is a properly resourced, supervised entity and that it is financially sound. It will have to be approved by the governance board (QIHF) and/or the trustee (RF). The Registrar must be notified of the appointment
	• This section deals with the appointment of a prime broker by the hedge fund manager. Due diligence criteria will be prescribed, but as yet seems to be un-defined. The section does not deal with any requirements to appoint more than 1 prime broker as currently appears to be the trend in other developed markets.	The regulations will address the appointment of more than 1 PB and we are currently not opposed to that suggestion as it could enhance risk diversification
8.2 Administrators	• A due diligence process should be followed when appointing a fund administrator – this is best practice.	The general requirement is that the fund administrator is supervised and that it is financially sound. The regulator is currently considering the regulation of fund administrators and it is anticipated that by the time the hedge fund regulations are implemented this aspect of regulation would have been resolved.
	• Clarification is required that the clause refers to "Fund Administrators" as defined and not to Transfer Agents, i.e.	The Registrar will require appointment of an independent fund administrator, as the administrator is responsible for the valuation of

	the agent managing the unit holder register.	assets, which must be done by an independent person.
	• The implication of FoF's no longer being able to use the administrator as custodian due to stringent custodian/trustee requirements will need to be assessed.	The comments are noted and have been taken into account by the regulator in its assessment of fund administrators.
	• Consideration should be given as to whether administrators should have similar due diligence, reporting and monitoring requirements as prescribed for Prime Brokers.	Agreed.
	• Clarity is required as to what would be defined as "separate"?	The reference is to the fund administrator and not a transfer agent.
	• There are numerous references in the proposed framework to "Independent Third Party" administration, as well as paragraph 8.2. which (briefly) deals with "Administrators". This is in line with international best practise and there are valid reasons for the use of an independent third party administrator. The Madoff case is possibly the best example and in South Africa the recent Relative Value Arbitrage Fund (RVAF). However, the matter needs to go further than simply having a directive recommending the engagement of an independent third party administrator. 1. There needs to be a definition of a third party administrator and the role that the third party has in the administration. 2. Proper regulatory control of independent third party administrators needs to be implemented. 3. Internationally there is full acceptance of the role and control of a third party administrator as a licenced entity.	Noted, will be considered.

	The current situation is that under FAIS there is no specific class for administrators and there is vacillation as to whether the fund administrator should require a category 1 licence or a Category 3 licence. Neither of these is specific enough to cover third party administration as they were never intended to cover this class of service that is purely administrative and execution on behalf of third parties. There is no decision making or advice given to investors. The administration of funds and especially hedge funds is complex and requires both capital input in the form of software systems and also well trained staff. By not having guidelines and properly defined requirements there is a danger that companies having a Category 1 licence could set themselves up as an administrator using spread sheets and untrained staff. Given that there is no hurdle to entry in this service funds could simply set up a third party administrator that is not independent but simply to meet their own requirements which may not be in the interests of providing investor protection. It is not the intention of IDS to recommend that there be considerable barriers to entry for new third party service providers. Our concern is that the investing public needs to be provided with better protection by having reputable, adequately capitalised and properly skilled staff in FSB regulated third party administrators. As such we support a requirement that the third party administrator should have at the least, an operational entity in South Africa. This will ensure proper regulatory oversight as well as easy availability for auditing purposes. • Attached hereto (Annexure A) is further information on the South African market defining the role of the Third Party Fund administrator. ***(See also IDS's documents***	

	Annexure A).	
	• A clear distinction should be made between "administration services provided by third party administrators" and administration as currently defined under CISCA, which is the responsibility of the CIS manager (i.e. the MANCO). CISCA defines "administration" as *…. any function performed in connection with a collective investment scheme including –* *(a) the management or control of a collective investment scheme;* *(b) the receipt, payment or investment of money or other assets, including income accruals, in respect of a collective investment scheme;* *(c) the sale, repurchase, issue or cancellation of a participatory interest in a collective investment scheme and the giving of advice or disclosure of information on any of those matters to investors or potential investors; and* *(d) the buying and selling of assets or the handing over thereof to a trustee or custodian for safe custody;*	The administration services contemplated under the hedge fund regulation are distinct from the CISCA definition of administration and that is the reason it was made clear in the framework document.
	Our reading of this paragraph is that it refers to third party fund administrators, providing investor and fund administration service.	This is correct.
	Currently there is no requirement under CISCA that administration must be undertaken independently of the manager (MANCO). However, such a requirement will have limited impact in the case of hedge funds brought within the	Please see comments above regarding the independent administrator.

	perimeter of CISCA because the vast majority are already administered by independent administrators. It could however amount to a dramatic change for existing CIS funds depending how the term "separate" is interpreted. Existing regulations governing trusteeships under CISCA require complete independence from the business and group of the scheme owner. Such an approach would require all providers to outsource administration to a wholly independent entity. Whether such segregation is required over and above oversight by an independent trustee is a moot point.	
	Fund administrators should furthermore be a regulated activity per se under FAIS. It is proposed that licences should be granted in the following fundamental categories: 1. Member/investor administration services covering the administration of investor/member records for pension funds and collective investment schemes. 2. Fund administration services covering the administration of segregated portfolio fund assets including transaction processing, position keeping, portfolio valuation and unitisation. 3. Bulking of investor assets as undertaken by LISP's and similar (currently covered under FAIS).	The regulator is currently assessing the regulation of administrators to address the concerns raised. Noted. Noted. Noted.
	Domicile The requirement that the administrator should be domiciled in South Africa is too restrictive. A local footprint and presence in South Africa should be required and a minimum set of activities, as well as (to be defined) to be performed within the jurisdiction of the	We remain of the view that the administrator must be located in South Africa if they are going to administer assets based in South Africa. This, amongst other things, will enable effective supervision and monitoring.

	regulator. Administrators should adhere to certain internationally recognised standards or be regulated by an appropriate body.	
	8.2.2 : • This is too onerous and does not recognise that non South African domiciled Fund Administrators are capable and often more capable than local ones. Companies such as BNY Mellon, Citco, Citi and State Street administer funds on a global scale in multiple jurisdictions and with higher levels of complexity. *It is recommended that the Fund Administrator be Registered to do business in a FSB recognised domicile and be able to meet the minimum operation requirements as set by CISCA or the FSB.*	Our concern regarding the domicilium of the administrator is informed by the location of the assets, if the assets are in South Africa, then the administrator must be close to the assets to perform proper valuation. As a result we require that the administrator is independent and is domiciled in South Africa.
	• The category of financial services provider that administrators will fall into needs to be clarified.	The regulator is considering this.
	• It is stated that Administrators should be registered as a financial services provider. It is not clear from the document under which regulation this is proposed. Will it be FAIS? In addition to the above, and in order to deal with investor taxation issues such as those related to Dividend Withholding Tax, it may be worth considering a requirement for the Administrators to be Regulated Intermediaries in so far as investor administration is concerned. Under existing frameworks, Prime Brokers and CSDPs who are regulated intermediaries do not have access to the hedge fund's investor base whereas the administrators do. With reference to the due diligence requirements expected of a Prime Broker per 8.1.6, and for the sake of consistency, should the same concept not	The comments are noted, please see various responses above.

	also apply to the appointment of an Administrator or for that matter, any other hedge fund service providers?	
	• *Clearly this registration requirement will be determined in FAIS.*	Correct.
	• With reference to our earlier comment as whether or not foreign restricted hedge funds managed by SA asset managers would be governed by this legislation, typically in respect of such foreign funds (that are not domiciled in SA), the administrators are foreign administrators that are not domiciled here and not registered as a FSP. We would argue that restricted hedge funds that are domiciled offshore should not be governed by this legislation (as they are regulated elsewhere) and that accordingly, administrators of such funds should not be required to be domiciled here or be registered as FSPs.	Foreign hedge funds offered to South Africans would be required to comply with the existing provisions under section 65 of CISCA and will therefore not be bound by the proposed hedge fund regulations.
8.2.3 Pricing by Manager :	• This is an interesting addition and a valid and good addition.	Noted.
	• It might be added that details of the pricing method or process should be provided/disclosed.	Noted.
	• This point is especially important for illiquid securities.	Noted.
	• We would argue strongly that managers should never provide input to the valuation and that this should not be permitted under any circumstances.	The valuation will be performed by an independent administrator. We do not view independence within a group as independent and therefore mean the narrow interpretation of independence.
9.:	• ***Refer to Annexure E for the detailed view as developed by the industry work group.***	Noted and will be considered in the drafting of regulations.

	• Are bonds defined as securities? If not bonds should specifically be included in the definition.	Bonds are generally and internationally regarded and included as securities.
9.1.1	• The wording 'operate regularly' has to be defined or removed from the clause as the rest of the clause can stand without this wording.	Noted, will be considered.
	• This paragraph refers: "including structured financial instruments if they meet the securities criteria". This phrase is not defined and therefore open to interpretation. For consistency across markets and regulation, it may be advisable in terms of definition (and for that matter all other definitions), to reference the SSA or Financial Markets Bill (Act). This section refers to assets that are listed. Is the intention to exclude unlisted companies that are about to list? What is the proposal regarding IPOs, where companies are going through the process to list? At what point can the Fund invest in such companies?	This can be clarified in the regulations. To the extent possible, we will be consistent with use of definitions and align with other definitions were applicable.
	9.1.2 Per above, for the sake of clarity, OTC derivatives and participatory interests should be referenced to the appropriate "universally accepted" market definition, e.g. "...as defined in terms of the Securities Services Act…."	Noted, please see comment above.
	9.2 The list of permitted and non-permitted asset classes also incorporates the criteria to be met. Consideration should be taken in separating the asset classes and the criteria.	Noted.
	9.2.1 • This clause appear to conflict with the allowed investment in OTC and all margined financial instruments. These instruments typically require no or small initial margins but with exposure to large potential gains and losses relative	The requirement is to be applied at overall portfolio level and not necessarily at instrument level.

	to the initial margin.	
	• Please confirm whether this means that the fund manager may not sell options whether in isolation or as part of a bigger option structure like a butterfly.	No, it does not mean that.
	• By implication, this paragraph seemingly excludes many derivative products, even some of the most simple OTC (CFD) and Exchange Traded products (SSFs) which provide exposure on a leveraged basis requiring margin. It is impossible to pay back the amount paid to acquire the derivative. Should this therefore read the "potential loss on investment is limited to the amount of invested" i.e. a guarantee by the retail hedge fund manager?	As indicated above, this provision is applicable at portfolio level and not at instrument level. Proposal is noted and will be considered in the drafting of regulations.
	• The proposed 9.2.1 (The potential loss on the investment is limited to the amount paid to acquire it) at instrument level seems unnecessarily onerous. It restricts the types of investments that hedge funds may make – for example in theory this requirement would prohibit short selling or using certain derivative strategies, whereas both short selling and the use of derivatives are explicitly allowed in the proposed legislation. In our opinion, the risk of losses at instrument level should rather be captured by the RMP, with the hedge fund manager obliged to detail in the RMP how instrument losses greater than the amount paid to acquire the particular instrument will be mitigated or avoided.	This does not apply at instrument level, since such an application would be onerous and seem to defeat the purpose of permitting investment in hedge funds. It is intended that the RMP will address losses at instrument level.
	• Proposed rules 9.2.1 and 9.9.1 are particularly disruptive and would require this firm to cease the current hedge fund.	Noted, please see comments above.
	• 9.2.1 This effectively rules out geared instruments such as futures, CFD's, or written options. Again liability is limited in the fund structure. By definition a geared instrument	Noted, please see comments above.

	has the potential to lose more than the margin put up. Every client agreement with the JSE derivatives division warns to this effect. *This must be removed as it will preclude a hedge fund from utilizing derivative instruments.*	
	• This requirement will further limit the instruments which can be traded. This effectively excludes all derivative instruments.	Noted, please see comments above.
	This will eliminate many, if not most of the top South African hedge funds from the retail hedge fund class. It effectively rules out geared instruments such as CFDs or written options. By definition a geared instrument has the potential to lose more than the margin put up. The liability of the client is limited in the fund structure. This regulation must be removed as it will restrict a retail hedge fund from utilizing derivative instruments.	Noted, please see comments above.
	9.2.2 • This limits the ability of funds to invest in small and mid-cap companies as their liquidity does not always allow them to unwind in the period. • *Further details are required before this proposal can be assessed*	Noted. Noted, further details will be provided in draft regulations
9.2.3	• Definition required for 'reliable valuation'.	Noted, definition will be provided. A reliable valuation would be one performed by an independent administrator if considered at time of trade.
	• The paragraph states that a "reliable valuation" must exist. This is once again a term that is open to interpretation, and should accordingly be defined in more detail.	Noted, please see comment above.
	• What is a reliable valuation?	Please see comment above. This will be made clear in the regulations.
9.2.4	• Definition required for 'Appropriate information'.	Appropriate information means the relevant information in respect of that instrument. However this will be considered in the regulations.

	• This paragraph states that “Appropriate information….” must be available. A more detailed definition is required to avoid too wide interpretation of what is “appropriate”.	Please see above. This will be made clear in the regulations
9.2.5	• It is not clear what is meant by the instrument having to be negotiable. We request clarification on whether this implies the need for there to be a contractual market maker in the instrument. A less onerous requirement would be that the instrument can be liquidated over a specified period of time and/or within a defined bid-offer cost.	Noted, will be considered.
	• Further details are required before this proposal can be assessed	Noted.
9.7.1.1 Indices Diversified	• Definition required for ‘sufficiently diversified’.	Noted.
	What extent conveys sufficiently?	It is noted that this may not be clear and will be addressed in the regulations.
	In addition to the point above – to what method of measuring diversification must it be sufficient? As there are numerous manners/ways to measure diversification.	Noted, will be clarified.
	• Further details are required before this proposal can be assessed	Noted, further details will be provided in the regulations.
9.7.1.2 Indices to be Adequate Benchmark :	• Definition required for ‘adequate benchmark’.	An adequate benchmark is one compiled by an independent index compiler.
	I do not agree with this point as at times a non-adequate benchmark would be used to hedge a position or portfolio – thus this is basically cutting off the innovation that a hedge fund uses to do its business.	Noted, comment will be considered more fully.
9.7.1.3 Indices to be Published Appropriately :	Definition required for ‘appropriate manner’.	Noted. Regarding the word “appropriate”, please refer to comments above. However comments will be considered to ensure that any possible confusion is clarified.
	• I do not agree with this point.	Noted.
	• Also, what does an appropriate manner refer to?	Please refer to comments above.

	• Not all indices are easily/readily/publicly available.	Noted.
	• It is stated that financial indices be "published in an appropriate manner". More detailed definition is required to avoid too wide interpretation of what is "appropriate" or acceptable.	Noted, for avoidance of doubt or confusion the matter will be reconsidered and/or clarified.
9.7.2 Indices :	• Why are fixed income indices not included?	Fixed income indices are not excluded, the framework refers to financial indices, therefore if a fixed income index is a financial index it is included.
	Metals are hard commodities	Yes.
9.8.2.1	It is unclear whether the term "prudential supervision" is limited to just the banks or whether independent financial advisors are also captured under this definition. It is our recommendation that this is clarified so that this additional body of people are also required to be prudentially supervised.	Prudential supervision is not only limited to the banks but also includes persons regulated by the registrar of securities, this would be the registrar of financial markets in terms of the FMA.
9.8.2.3 OTC :	• Not all OTC securities are liquid in South Africa – thus this point can be problematic and also stifle the hedge fund of doing its business.	This is a requirement on the RF and not the QIHF. It serves to manage liquidity in the fund. The question is however still under consideration.
	The criterion is too vague and impractical to implement i.e. only liquid derivatives qualify.	Noted.
9.9 :	We don't understand why indirect investments in property, commodities or private equity would not be permitted? For example a listed company that invests in property or private equity? Or a derivative linked to a commodity like gold?	Indirect exposure will be permitted, however direct exposure (by RH?) is not permitted as it will affect the liquidity of the fund. We will not permit physical exposure to real estate and commodities.
9.9.1 :	• We provide administration services to quite a few commodity hedge funds with excellent track records. This proposal will close all of these funds with immediate effect, even though some of these funds have been	At this stage, we are not considering permitting physical exposure to commodities by RFs as this has the possibility of affecting the liquidity of the fund. If there is cash settlement, then it would be permitted. However, the matter will be considered again when drafting the

	providing excellent and well-diversified returns for their investors for almost 10 years. Notwithstanding the fact that most of these funds almost exclusively utilise derivatives where delivery is possible, not once have they taken delivery of physical commodities. Furthermore, these funds provide an essential service to the commodity markets. Services mainly include: • providing liquidity to hedgers (both producers and consumers) and other; • speculators; • assuming risks on behalf of hedgers; and • reflecting economic reality of supply and demand through expressing their view, signalling abundance or lack of supply to both producers and consumers. In addition, the certificates presenting commodity holdings are valid tradable financial instruments, backed by an exchange. This provides assurance and comfort to both the manager and the fund's investors. It should be noted that the global financial crisis did not come about from speculation in commodities, but from debt instruments. We are of the opinion that commodities provide an excellent diversification away from equities and bonds. Why should retail investors be precluded from this market?	regulations.
	• We would be interested in understanding further the proposed restriction on investment in commodities where there is physical delivery. As you are no doubt aware, the physically settled commodities market is amongst the most liquid of the South African commodities offerings.	If there is cash settlement that will be permissible. Please see comments above.
	• A case study may be made of the Badger Quant fund. The fund is focused on commodity derivatives, almost exclusively utilizing derivatives on commodities where delivery is possible. It has been in existence for 9 years and	Please see comments above. This will be considered for purposes of the regulations.

	has not once taken delivery of physical commodities. Some hedge funds ensure “honesty” to the commodity derivate markets. This happens in a process where carry and spread trades are entered into with the objective to arbitrage between different delivery dates. This process ensures that the market remains coherent in that contracts with different expiry dates remain priced to reflect the economic cost of storing and financing commodity storage. *In order to do this, delivery and storage must be possible.* Certificates presenting commodity holdings are valid tradable financial instruments, backed by an exchange. The global financial crisis did not come about from speculation in commodities but from debt instruments. In the grains and livestock markets in the United States, commodity hedge funds make up a healthy industry. In similar fashion many local hedge funds provide an economic service to South African grain markets: · by providing liquidity to hedgers (producers and millers), · by assuming risks that hedgers do not want, · by applying specialist knowledge to the market (eg producers do not have the time nor skill to hedge price risk, they lay this off to traders that assume the producer’s price risk, and apply financial knowledge to manage the risk effectively. This ultimately benefits the consumer as each party focus on his area of knowledge). · by keeping the market “honest” through relative value	

	trades. · by reflecting economic reality of supply and demand through expressing their view, signalling abundance or lack of supply to producers *Why should retail investors be precluded from this market?*	
	• Restricting the trade of commodities – Commodities are a globally recognized asset and investment class. Commodities can also be significantly less risky than equities. Case in point is the decline in equity price of ACL, that declined 90% from June 2008 to current. You will not see market declines of that magnitude in commodities. SAFEX now lists a number of commodities. The rationale behind the listing of the new energy and hard commodities was to give the local investing public additional diversification scope. What would be the reasoning behind removing that? Also consider the movement of the share prices of platinum producers vs the actual movement in the price of platinum. In this case it would have been much less risky investing in the actual commodity than in the listed equity. There are numerous other examples. To end this point, I need to point out that there are a number of small hedge funds trading commodities (commodity only funds, as well as funds trading commodities along with equities). This proposal will close all of these funds.	Indirect exposure will be permitted. The regulations will provide accordingly.
	This will have the effect that some of the top South African hedge funds will be excluded from this class as some of these funds are focussed on commodity derivatives and almost exclusively utilize derivatives on commodities where delivery is possible. None of these funds ever take physical	Indirect exposure will be permitted, please see comments above.

	delivery of these commodities and some of these funds have been in existence for almost 10 years. A common misconception is that the 2008 global financial crises came about from speculation in commodities whereas it was rather the speculation in debt instruments that caused the crisis. (KANAAN TRUST).	
9.9.2	*It is difficult to understand why these two asset classes have been excluded. These underlying asset classes are not inherently more risky. Excluding these asset classes is not consistent with Collective Investment Schemes in Property or listed commodity products.*	This applies to RF and is meant to ensure liquidity in the fund. Direct exposure will be further debated during drafting of regulations. Will affect the ability of the fund to maintain liquidity.
9.9.3 private Equity as a Non-permitted Asset :	Question: Why would private equity not be permitted as an eligible asset class?	Private equity may affect the liquidity of the fund therefore it is not permitted for investment.
9.11	*Financial Indices may include exposure to commodities and property (i.e. non-permitted assets) Is it the intention to exclude these, for example the Top 40?*	The issue with commodities is that they impact the ability of the hedge fund manager to meet its liquidity requirements. If it is not going to be physically settled then it may be allowed. However financial indices are permitted as provided for in the framework document.
	10. INVESTMENT PARAMETERS FOR RETAIL HEDGE FUNDS ***Refer to Annexure E for the detailed view as developed by the industry work group.***	This annexure will be considered when the regulations are drafted.
10.1 and 10.2 :	Please note that the information in these two sections are somewhat poorly conveyed.	Noted, we will look at ways of addressing concerns.
	This section largely reproduces CISCA Notice 80. We propose that the investment parameters be more succinctly expressed as being consistent with CISCA Notice 80 spreading requirements allowing for the appropriate relaxations on shorting and leverage. For example, Notice 80 (17) (3) would be replaced by the proposed Commitment and VAR rules.	Yes.
10.1	Equity Securities – Footnote 17 refers to UCITS rules, and	We will consider proposals for different spreading requirements. It will

	one would tend to agree with the notes to the suitability (or lack thereof) of these rules in a South African context.	be considered in the SA context.
10.1 to 10.5 :	These clauses are overly restrictive and likely to influence the investment decisions to the detriment of the fund. We recommend that tracking the funds value in these categories for transparency purposes may be a better approach.	Noted. Similar limits to those stipulated in BN 80 will be included in addition to what is currently in the framework.
10.2:	It needs to be clarified whether the amount referred to in the table in 10.2 is the notional amount or the market exposure amount for fixed income instruments. For example if one purchases a bond for R5m the notional amount of that bond may be R5m, however the market exposure or PV01 may only be R15,000. This difference has significant implications, hence the need for further clarification. If one is using the notional as a base, fixed income strategies will not be able to provide an offering in the retail hedge fund space. This is of concern to us as the volatility on these strategies tends to be lower than equity-type strategies and they are the fastest growing and best performing strategy in South Africa.	The notional amount was intended, and concerns on the implications thereof have been noted and will be further discussed
Footnote 17 :	I agree with the statement in footnote 17 that these concentration limits may be restrictive (especially in the SA market). These limits will have to be reviewed.	Noted. See above.
10.3.2 Derivative Exposure :	The idea/concept is pure and idealistic, but the limits will have to be substantiated.	The limits will be revised.
	Refers to a 10% limit of NAV to a single OTC derivative counterparty, however in point 6.7.5 counterparty risk is limited to 20%. Please can you provide further clarification as to the difference between the two limits.	The 10% is not notional but actual mark to market exposure that can be lost plus the over collateralised amount. 20% is overall counterparty exposure.
	Consideration should be given as to whether or not this is an appropriate exposure limit (too low) given the size and available options within the local market.	It refers specifically to OTC derivatives.
	What are qualifying credit institutions? Is this exposure or	Credit institutions will be defined in the regulations. See above

	unsettled mtm exposure? This requirement is inconsistent with6.7.5 and Regulation 28.	regarding limits. These limits apply to RF.
10.3.3 Derivative Leverage Limits :	I agree with this point and the limit proposed.	Noted.
	Again, we would argue that the reference to 100% in this paragraph should read 200%	Noted, will be addressed.
	Leverage Limits: This paragraph does not appear to take consideration of which asset class the funds may be invested in (equity bias). There is potential that leverage limits as currently proposed will render hedge funds in certain asset classes unviable.	Noted, will be considered.
	It is critical that a VAR based alternative is permitted.	Noted and agree.
	The limits described here will eliminate many arbitrage hedge funds and fixed income hedge funds who often use large amounts of leverage to make the small gains viable in their strategy.	Noted, this will be considered.
10.3.4 Maximum Level of Leverage :	This point is pure and idealistic, and I concur with the aspects listed.	Noted.
10.4.1	I concur with this limit while this proposal is also of good nature.	Noted.
	This requirement? is problematic for multi-strategy products and ironically may increase risk or complexity.	Disagree, diversity of assets should decrease risk.
10.4.2	We propose that the 10% limit be replaced with 20% to achieve consistency with CISCA Notice 80.	BN 80 does not contain limit of own portfolio. The 10% limit is consistent with UCITs.
10.4.3 & 10.4.6 :	I concur. Specific guidelines in terms of due diligence standards may have to be prescribed, for instance funds of hedge fund managers should follow the due diligence process and questionnaire as laid out by the CAIA – as this will induce confidence and trust, and also create uniformity.	Noted.

10.5 :	This proposal is warranted – especially in the SA market.	Noted.
	This restriction may be particularly onerous depending on what instruments are included in the definition of unlisted or unregulated securities. These could for instance include NCD's, deposits, or derivatives.	This will be amended to apply to unregulated products.
	Clarity is required as to whether this 10% allowance also permits the inclusion of items that are not permitted in terms of clause 9.9.	No, it is not permitted. Assets that are not permissible may not be included.
11.2.1 :	More detailed definition is required as to what is "economically appropriate" or "cost effective". Both phrases are subjective and open to interpretation.	What is economically appropriate will be clear from the particular circumstances and it may not be necessary to provide a definition. We will consider and provide clarity..
11.2.2 :	I concur with this point. The reasons listed are also realistic and pure.	Noted.
	This clause is too restrictive. How can risk and cost reduction be proved? What about alpha generation/expressing an investment view as one of the reasons which are currently not outlined.	Disagree. An investment view is not a singular basis for investment.
11.3	Definition required for 'naked short selling'.	By naked short selling we mean the practice of short selling an asset without borrowing the asset or ensuring that it can be borrowed. It will be clarified in the regulations.
	I concur with this point.	Noted.
	For purposes of clarity, naked short-selling should probably be defined.	Please see comment above.
	Naked short selling should be defined in more detail for the sake of clarity.	Please see comment above.
	We disagree with this proposal and it will eliminate the prospect of a number of strategies for instance market neutral funds being included. From a risk perspective, this	The comment appears to contradict itself, in that the commentator acknowledges that the JSE Rules also prohibit naked short selling.

	does not make sense. Naked short selling is in any event prohibited in terms of the Rules of the JSE.	
GENERAL COMMENTS		
	Thank you for the opportunity to submit comments on the above policy framework document, as per the press release dated 13 September 2012. 2. These comments address four issues, namely:	
	2.1. the types of portfolios which are to be regulated as "declared collective investment schemes" pursuant to the anticipated notice in the Government Gazette by the Minister of Finance in terms of section 63 of the Collective Investment Schemes Control Act, 2002 ("CISCA");	
	2.2. the position in respect of third-party branded arrangements;	
	2.3. the position in respect of foreign collective investment schemes; and	
	2.4. transitional arrangements.	
	3. For ease of reference, we quote relevant definitions from CISCA (including the definition of "collective investment scheme" in the Annexure hereto). Types of Portfolios to be Regulated	
	4. Section 63 of CISCA provides that the Minister may by notice in the Government Gazette declare a specific type of business to be a collective investment scheme to which CISCA or any part or provision thereof applies, and that the Minister may issue different notices for different types of collective investment schemes. In terms of section 63 of CISCA, such notice may (i) define the business activity of a declared collective investment scheme; (ii) stipulate which provisions of CISCA will apply to such declared scheme; and	

	(iii) specify the matters which must be included in the deed of the declared scheme. Section 62 of CISCA provides that a "declared collective investment scheme" means a collective investment scheme, other than a collective investment scheme [registered as] a collective investment scheme in securities, property or participation bonds, which has been declared to be a collective investment scheme under section 63.	
	A legal question which arises is whether the Minister has: 5.1. the power to declare any business a collective investment scheme, regardless of whether such business otherwise meets the definition of a "collective investment scheme" as defined in section 1 of CISCA; or 5.2. whether the relevant business must in the first place meet the definition of a "collective investment scheme" in section 1 of CISCA, in which case the Minister's notice is merely a confirmation that such business falls to be regulated by CISCA and will be regulated in the manner set out in the notice.	The Minister is empowered to declare any type of business as a collective investment scheme in which case it becomes a declared collective investment scheme regardless of whether that business meets the definition of a collective investment scheme. The business therefore does not necessarily need to meet the definition of a collective investment scheme.
	6. This legal question is relevant since, broadly speaking, in our experience hedge funds have – in order to avoid the application of CISCA – not invited or permitted "members of the public" (as defined in section 1 of CISCA) to invest. Accordingly, many hedge funds would therefore not presently constitute "collective investment scheme[s]" as defined in section 1 of CISCA, since it is an essential element of that definition that a collective investment scheme only exists where members of the public are invited or permitted to invest in the scheme.	Noted, however hedge funds will now be permitted for investment by members of the public, especially through the RF. CISCA views pension funds, for example, as members of the public, and therefore it might not be entirely correct to state that hedge funds have not permitted members of the public to invest.
	7. In addition, some hedge fund portfolios have only one	The intention is to declare the business of a hedge fund as a declared

	investor or are structured in such a way that the investors do not contribute directly to the underlying portfolio. In these circumstances, the relevant hedge fund portfolio would not meet the definition of a “collective investment scheme” as defined in section 1 of CISCA.	collective investment scheme. Therefore, if a fund undertakes the business of, or operates as, a hedge fund, then it would be required to register. Such a fund could be exempted from the requirements, however it would have to apply for registration before the exemption is granted.
	8. A policy question which arises is whether the contemplated notice (or notices) under section 63 of CISCA should be drafted (i) to include on a compulsory basis the broadest possible selection of hedge fund portfolios or (ii) to facilitate the registration of hedge fund portfolios, on the basis that most hedge funds would welcome the opportunity to become so regulated and investors would require it.	The policy decision has been taken to regulate all hedge funds, therefore they will all be required to register.
	9. We appreciate that the above legal and policy questions will be considered by the regulator. (It falls outside the scope of these comments to do so.) We note though that the questions are especially relevant in relation to the so-called “restricted hedge funds” mentioned in paragraph 2.3 of the September 2012 policy framework document, since the document indicates that “restricted hedge funds” will be included in the ambit of the anticipated section 63 notice despite the fact that such “restricted hedge funds” do not invite or permit investment from members of the public.	Please see comments above.
	10. If the section 63 notice will indeed include such “restricted hedge funds”, then in our view it will be necessary to specifically define within the applicable notice the type of business which will be included within the ambit of the declared collective investment scheme. This will, in our view, have to be done without reference to the general definition of a “collective investment scheme” in clause 1 of CISCA (which will not be applicable, given that “members of the public” will not be invited or permitted to invest in “restricted hedge funds”).	Please see comments above.

	11. We suggest that both “restricted hedge funds” and “retail hedge funds” domiciled in South Africa should only be declared collective investment schemes if: 11.1. there are at least two investors in the relevant portfolio (In this respect we suggest that relevant financial institutions, such as insurance companies or pension funds, should be counted on the basis that one institution equals one investor); and 11.2. the discretionary fund manager to the relevant portfolio is required under the Financial Advisory and Intermediary Services Act, 2002 to be approved as a hedge fund financial services provider (holding a category IIA licence).	The comments are noted and will be considered.
	The ambit of application of the proposed section 63 notice is such an important issue that we suggest that a draft of the notice should be made available for comment by the public before it is finalised.	Noted. All the relevant regulations will be first issued for public comments before finalised.
	<u>Third-Party Branded Arrangements</u> 13. Single hedge fund managers (which are typically companies with one or two qualified individual managers) may find it too costly to comply with the requirements relating to managers approved under CISCA.	As indicated in the responses above, QIHFs will not be required to establish a MANCO. The intention is not to disrupt the existing structures too much particularly in respect of the QIHF. The RF will be required to adopt the CISCA MANCO structure, that is to say a RF scheme would comprise the manager (MANCO) and the Trustee. If a Cat IIA FSP intends establishing a retail hedge fund they will be required to establish a MANCO however if the intention is to continue as a qualified hedge fund there will not be a requirement for a MANCO. However the entity responsible for the day to day affairs of the fund will be required to register as a CIS manager (because the law will deem every hedge fund a CIS) and will have to have a governance structure (responsible for fiduciary oversight).
	In order not to exclude single hedge fund managers from the future regulatory regime, we suggest that such single hedge fund managers should be entitled to make use of third-party	Smaller funds will be permitted to use the third party arrangements as suggested.

	branded arrangements regulated under Notice 778 of 4 November 2011.	
	In this regard, we note that any requirement that the manager approved under CISCA should underwrite the solvency of the applicable hedge fund portfolio (see in this regard paragraph 6.1.2 of the September 2012 policy framework document) will likely deter the use of third-party branded arrangements.	Noted.
	Foreign Collective Investment Schemes 16. Broadly speaking, the "Conditions in respect of a collective investment scheme carried on outside but promoted in the Republic" (Notice 2076 of 1 August 2003, as amended) require that the investments of the foreign collective investment scheme applying for approval under section 65 of CISCA should have a risk profile which is not significantly higher than the risk profile of similar investments in participatory interests offered for sale in South Africa by managers registered under CISCA. In this regard, the use by the foreign collective investment scheme of (i) leverage; (ii) unlisted derivative instruments; or (iii) uncovered derivative exposures are listed in Notice 2076 as specific grounds on which approval may be refused.	The notice for foreign collective investment schemes has been revised and this provision is no longer applicable. Foreign hedge funds would be permitted for investment in South Africa in terms of the revised notice.
	17. If local hedge funds will be regulated under CISCA, then Notice 2076 and the relevant policies of the Registrar of Collective Investment Schemes in relation to the approval under section 65 of CISCA of foreign collective investment schemes who employ leverage or unlisted derivatives as part of their investment strategy should also, in our view, be reviewed and amended.	The notice referred to has been amended and will come into effect in January 2014.
	Interim and Transitional Arrangements 18. It is important that hedge fund financial services providers and their affiliates be permitted sufficient time to: 18.1. make the relevant applications for approval as	There will be a transitional period. The period is still under consideration, but the suggestion is noted.

	managers and/or trustees/custodians under CISCA, and to deal with any queries from the regulator in relation to such applications; 18.2. amend relevant contractual arrangements; and 18.3. obtain any investor approvals which may be required in respect of the amendment of the existing investment structures. We would suggest that a period of two years following the publication of the section 63 notice would be a sufficient transitional period, after which compliance with the applicable requirements could be made compulsory.	
	19. On a practical level, we suggest that consideration should be given to the following: 19.1. measures to create a level playing field for hedge fund applicants – for example, one way to achieve this could be for the FSB to invite applications for registration as a manager under CISCA to be submitted by a certain date and then to indicate the likely time frame within which applications submitted by such date will be dealt with; and 19.2. measures to assist hedge funds with compliance – for example, the FSB could, following the publication of the section 63 notice, have regular meetings with industry bodies so that any difficulties experienced with the application process under CISCA can be communicated and relevant guidance given.	Noted, this will be considered and this is the process that is most likely to be followed. The Regulator and NT will continue to engage with the industry to ensure compliance.
	3. General **3.1. Scope of the draft Regulation** The scope of application for the draft regulation, is it intended to cover only Collective Investment Schemes (CIS) as defined in the Collective Schemes Control Act ("CISCA")? As the draft regulation will ultimately be housed in CISCA, this is the inference. Note that CIS "means a scheme, in whatever form, including an open-ended investment	Please see above regarding the scope of regulation and the declaration in terms of section 63. Briefly the intention is to declare the business of hedge funds as a declared collective investment scheme without reference to the definition of a collective investment scheme in terms of CISCA. All hedge funds will be required to register as hedge funds. They will either register as Qualified Investor Hedge Funds (QIHF) or Retail Hedge Funds (RF).

	company, in pursuance of which members of the public are invited or permitted to invest money or other assets in a portfolio, and in terms of which a) two or more investors contribute money or other assets to and hold a participatory interest in a portfolio of the scheme through shares, units or any other form of participatory interest; and b) the investors share the risk and the benefit of investment in proportion to their participatory interest in a portfolio of a scheme or on any other basis determined in the deed, but not a collective investment scheme authorized by any other Act;" And "members of the public includes a)members of any section of the public, whether selected as clients, members, shareholders, employees or ex-employees of the person issuing an invitation to acquire a participatory interest in a portfolio; and b) a financial institution regulated by any law, but excludes persons confined to a restricted circle of individuals with a common interest who receive the invitation in circumstances which can properly be regarded as a domestic or private business venture between those persons and the person issuing the invitation;" We would therefore assume that private enterprise as	Comments noted. The issue on how best to regulate private arrangements still requires further discussion and a final decision. This will be done during the drafting phase of the regulations, and industry bodies will also assist in this decision making and drafting process.

	envisaged under CISCA does not fall within scope. Therefore an approved portfolio manager can continue to operate discretionary portfolio management agreements. At the discretion of the portfolio manager (PM), investments may be made in local or foreign funds. Also the selection of stocks /instruments/investments, which is at the discretion of the PM in accordance with the mandate, and the way the portfolio is operated, may be similar to a hedge fund strategy. Please see the Alternative Investment Fund managers Directive ("AIFMD"), page 2, where in Switzerland, (i) unsolicited investment, and (ii) discretionary portfolio management is exempted. The references to Restricted Hedge Funds would therefore mean any pooled investment which meets the definition of a CIS. We would also suggest that for such Restricted Hedge Funds, regulation is limited as follows (as it is inappropriate to micro manage the Fund): a) The Hedge Fund Manager (HFM) – to set standards for behaviour, and Reporting, b) That the HFM and hedge fund (HF) be subject to annual audits c) Prescribed standards/methodologies for valuation, pricing and performance of the HF d) Transparency and Disclosure for the HFM and HF e) HF not necessarily required to be a Company f) More flexibility with respect to the functions carried out by a Prime Broker vs. the Administrator. Other "General" points to be considered: The proposed framework although still in its infancy, suggests a future whereby the operational ability of fund managers will need to be increased significantly either by way of additional staffing, up-skilling or outsourcing, with some duplication in	

	terms of alignment to FAIS and CISCA, all of which will have cost implications, and may be barrier to entry for new independent fund managers.	
	2. Practical Implications For existing fund managers who have traditionally operated with small teams, outsourcing the majority of their administrative functions, additional costs may render funds no longer viable. (There is no clarity on the proposed framework with regards to the use of third party vendors and the outsourcing of various activities.) The CISCA framework is already relatively familiar to the bigger institutional asset managers, who have relevant resources, infrastructure and distribution channels for retail clients, perhaps giving them a competitive advantage over the smaller niche hedge fund managers who will in all likelihood henceforth be confined to their traditional investor markets – provided of course that clarity and appropriate definition can be achieved in respect of things like "qualified investors". There is a sense that the proposed framework has been drafted in some degree of isolation, not necessarily fully cognisant of related legislation and regulation such as Regulation 28 of the Pension Funds Act, and the Financial Markets Bill.	The published framework intended to provide a high level regulatory structure, with some details, for the envisaged actual regulations. The actual regulations will certainly be drafted in view of what is currently in other relevant and related legislation like Reg 28 and the Financial Markets Act, where relevant and applicable.
	Exposure: It is requested that "Gross Exposure" replaces the current references to "Total exposure" and "Leverage". "Total Exposure" as understood in UCITS only refers to the exposure obtained through derivatives positions, after taking netting and hedging into account. Such a measure would, in our opinion, lead to a very narrow interpretation of risk. We therefore strongly support the use of "gross exposure" (as defined within the ASISA submission) to incorporate all portfolio holdings.	Noted. This will be considered. We chose total exposure as it was thought that this would be easier to understand in the South African context. Definitions will be considered more fully in the drafting of regulations.

End