Opening Statement

Chairman Michael G. Oxley

Committee on Financial Services

Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises

The Long and Short of Hedge Funds: Effects of Strategies for Managing Market Risk

May 22, 2003

Thank you Chairman Baker for holding this important hearing. The growth of the hedge fund industry makes it incumbent upon this Committee to examine whether there are sufficient investor protections currently in place. Pursuant to the Committee's ongoing efforts to restore investor confidence, we are reviewing the financial products in our marketplace to ensure that investors are being treated fairly and appropriately. Some have argued that hedge funds are not an appropriate investment for retail investors; others suggest that all Americans should be given access.

Some have raised concerns about the lack of transparency in this industry, given its size, scope, and impact on the markets. Our review of this industry will help us determine whether additional regulatory scrutiny is warranted, or whether additional regulations would actually harm investors and the markets.

Indeed, hedge funds have served their investors well throughout the recent bear market. The average hedge fund has recorded impressive gains in these difficult markets, and done so with less risk than the average mutual fund.

The industry has experienced considerable growth over the past decade, increasing in size from approximately $50 billion in assets to about $600 billion today. In just the past five years, the number of funds has doubled, with about 3,500 new hedge funds opening for business. This explosion in growth has been fueled by good performance and growing interest from large institutional investors such as pension funds, charitable foundations, and university endowments.

Concerns have been raised that many financial services companies – trying to capitalize on the exceptional performance of hedge funds – have begun to market portfolios of hedge funds to retail investors. These "funds of hedge funds" are registered investment companies that typically invest in 20-30 hedge funds. They usually require lower minimum investments than traditional hedge funds. It is my understanding that these financial products – which have been available to institutional investors for some time – are only being sold to investors who meet the income or net worth requirements of traditional hedge funds.

But while hedge funds are currently being sold only to "accredited" investors, it is my understanding that the funds of funds are only doing so because they do not wish to sell to retail investors. There may be a concern that, given the lack of a statutory restriction, they could, in the future, change their guidelines and sell to retail investors. I look forward to learning from Chairman Donaldson what the Commission has found thus far regarding the access to hedge funds by these investors. Some question why retail investors are being denied access to these important financial risk-balancing tools simply because they are not wealthy. Today's panel will help illuminate this debate.

Some have raised concerns about short-selling and its potential use to manipulate the market. I am pleased that the Commission is examining these issues in its ongoing review of hedge funds and the markets and I look forward to hearing the views of Chairman Donaldson and our other witnesses on the effectiveness of existing laws prohibiting such activity.

I applaud the SEC's year-long review of hedge funds and eagerly await the forthcoming staff report. There are many important investor protection and capital formation issues to be addressed. This Committee, and the Commission, must proceed with an abundance of caution as we examine this industry, which has served its investors well and provides important benefits to the markets.

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