

Comparative framework of hedge funds

Feature	Hedge fund	Mutual fund	Proprietary trading unit of a bank holding company
Capital and liquidity	Capital privately sourced. Offers periodic liquidity Limits to redemption may include, redemption windows or notice periods, gates, suspension rights and the use of side-pockets.	Capital raised through public share subscriptions, including retail investors Generally offering daily liquidity.	Amount of capital or balance sheet allocated to proprietary business may be limited by the resulting impact on the regulatory capital requirements of the banking group.
Leverage	Depends on the strategies of the fund and its risk parameters.	Substantive restrictions on use of leverage, shorts, options and purchase of securities on margin.	Constrained by SEC's liquidity based minimum net capital and customer protection rules and regulatory risk capital requirements that impose high risk weights on uncollateralised credit exposure to broker-dealers based on their credit rating. In 2004 the SEC introduced its alternative net capital rule that permits value at risk based modelling of net capital requirements. There has been a debate on whether this rule had the effect of enabling investment banks to increase their use of leverage.
Investment flexibility	Fund managers typically retain broad flexibility as a necessary tool for realising the fund's absolute return objective, within the limits imposed by the fund's permitted strategies, risk parameters and compliance with the Investment Advisers Act.	The Investment Company Act imposes restrictive standards, including, liquidity requirements, minimum asset coverage requirements, standards of governance and independent board membership, restrictions on transactions with affiliates, limits on permissible investments and concentration of	Constraints may arise from broker-dealer conduct rules (such as limits on participation in new issues, mark-up and fair pricing rules) and merchant banking investments rules of Bank Holding Company Act. Trading restrictions from investment banking activities (for example, restrictions imposed by

		<p>investments.</p> <p>Participation of retail investors in mutual funds attracts closer oversight by regulators (such as recent increase in maintenance margin for leveraged and inverse exchange traded funds (ETFs) or non-traditional ETFs).</p>	<p>foreign take-over panels) may apply absent exemptions based on existence of informational walls between the proprietary unit and investment banking services.</p>
Incentive compensation	<p>The Investment Advisers Act permits collection of performance fees from 3(c)(7) funds and high net-worth investors. Fee structure typically 2% management/20% performance subject to a high water mark.</p>	<p>The Investment Company Act imposes a fiduciary obligation on the manager on compensation received from shareholders. This constrains managers' ability to charge performance fees. The appropriate standard for determining what is consistent with fiduciary obligations of the manager has been the subject of debate and is now before the US Supreme Court (Jones v. Harris Associates). Fee structure: base fee, distribution expenses and transaction fees (which may be front loaded).</p>	<p>Subject to the banking group's compensation policies and regulatory oversight.</p>
Regulatory Framework	<p>Managers of 3(c)(i) and 3(c)(7) funds with less than 15 clients (private advisers) are exempt from SEC registration. They are comparatively lightly regulated and are primarily subject to anti-fraud and anti-market manipulation provisions of securities laws and regulations They are also subject to SEC disclosure and reporting requirements for large beneficial ownerships of listed companies, anti-money laundering laws</p>	<p>Strictly regulated under The Investment Company Act.</p>	<p>Substantive regulations under the Securities Exchange Act and related rules, Financial Industry Regulatory Authority (FINRA) regulations and applicable regulations of various exchanges.</p>

	<p>and any filing/disclosure obligations in the local jurisdictions where the manager and the funds are organized or carry on business.</p> <p>SEC registered fund managers are also subject to the regulatory framework of the Investment Advisers Act and related SEC rules, including SEC examinations, extensive recordkeeping requirements, expanded anti-fraud and anti-manipulation provisions, requirements relating to conflicts of interests, proxy voting, principal/agency/cross-trades, trade allocation, best execution, annual financial audit, custody, marketing, supervisory and compliance procedures and standards of conduct.</p> <p>Fund managers that invest in commodities may be required to register with the CFTC as a commodity pool operator or commodity trading advisor (CTA).</p> <p>Most hedge fund managers fall within one or more exemptions from registration.</p>		
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