Raising the Bar for Hedge Funds: Self-Policing Preferable to Over-Regulation

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2010

Objective:
This article explores ways in which the hedge fund industry can use higher levels of ethics and transparency to increase confidence in the industry, as well as helping to better their market prospects, given the industry’s unique position as a largely independent group.

Key findings:
• Self-policing has been shown to be effective, especially as a complement to regulatory agencies involved in external monitoring
• Self-regulation with high standards will lead to an elevated set of expectations on the part of investors
• Elevating the role of ethics and making it a fundamental corollary to the normal functioning of the hedge fund market will help to restore public confidence in the industry and enhance market forces

Conclusion:
The challenge for hedge funds to move in the direction of high ethical expectations, transparency and accountability is a difficult one. However, there is clear value to doing so, in terms of reducing compliance costs, enhancing the confidence of investors, improving corporate culture and employee satisfaction, and generally enhance the company’s image to involved stakeholders.

If the hedge fund industry does not self-regulate, it is likely that governments will feel pressure to regulate on their behalf. While this would not be the worst case scenario, studies are reported to show that self-regulation would be more effective and useful for the industry which has heretofore experienced high levels of independence.

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