Bloomberg

Hedge Funds Withdraw SEC Registrations After Ruling (Update6)

By Jesse Westbrook - Sep 22, 2006

Sept. 22 (Bloomberg) -- More than 100 hedge funds will provide less information to regulators after a court said the U.S. Securities and Exchange Commission can't enforce a rule that required more disclosure by the industry.

D.B. Zwirn & Co. and Mason Capital Management LLC, which together manage almost $7 billion of assets, are among the funds that withdrew registrations since the federal appeals court in Washington made its ruling in June, according to SEC records.

Some opted out this month, while Greenwich, Connecticut- based Amaranth Advisors LLC was losing about $6 billion on bad bets in the natural-gas market. The SEC wanted hedge funds to report their size, number of employees and types of clients, and submit to random inspections.

``I have said for a long while that a train wreck might well occur because of a failure of adequate regulatory oversight,'' said former SEC Commissioner Harvey Goldschmid, who voted for the agency's hedge fund rule. ``Amaranth only indicates the continuation of that concern.''

Amaranth's losses swelled by $1.4 billion this week because the firm had to unload assets at a discount to avoid a shutdown. Founder Nicholas Maounis is planning a conference call later today to update investors.

Funds run by MotherRock LP, Saranac Capital Management LP and Ospraie Management LLC closed this year after losses in commodities and convertible bonds. Aeneas Capital Management LP, which managed as much as $400 million, is under investigation by regulators in the U.S. and Malaysia after bets on Malaysian stocks caused losses of about 60 percent in one of its funds.

Fund Inflows

Hedge funds are private pools of capital that allow managers to participate substantially in the gains on investments made on behalf of clients. They typically levy annual management fees of 2 percent of assets and pocket 20 percent or more of the funds' gains. Amaranth's management and performance fees were 1.5 percent and 20 percent, marketing documents show.

More than $42 billion flowed into hedge funds in the three months ended June 30, the most in one quarter since at least 2003, according to data compiled by Chicago-based Hedge Fund Research Inc.

The SEC's hedge fund rule was prompted in part by the September 1998 collapse of Long-Term Capital Management LP, which borrowed enough to make $125 billion of bets with $2.3 billion of equity. The size of its positions and the threat its meltdown posed to financial markets alarmed regulators, and the Federal Reserve Bank of New York organized a Wall Street bailout.

Market Risk

The hedge fund industry now manages $1.2 trillion in assets, a figure that has doubled in the past five years, Hedge Fund Research reported. Hedge funds now account for about 30 percent of U.S. equity trading.

SEC Chairman Christopher Cox told senators in July that hedge fund regulation is ``inadequate'' and Congress may need to impose more oversight. Since June, the Treasury Department has been running an inquiry into the impact of hedge funds on financial markets.

The number of hedge funds pulling registrations from the SEC has doubled in the past three weeks to 106. New York-based D.B. Zwirn, with $4.7 billion under management as of July 1, withdrew its SEC registration on Sept. 5, according to the agency's Web site. Mason Capital, which manages $2.1 billion and also is based in New York, ``de-registered'' three days later.

SEC spokesman John Heine said 70 hedge fund managers told the agency they opted out because registration is no longer required. The other 36 may have withdrawn for any number of reasons, such as closing down their funds, he said.

At the same time, 34 new fund managers have registered since the court ruling. Heine declined to name any.

Spot Checks

A total 2,479 of the roughly 7,000 U.S.-based funds remain registered with the SEC and subject to spot-checks. Those that stay probably are doing so to attract pension plans and charitable foundations, which are more concerned with regulatory compliance, said Barry Barbash, a former director of the SEC's investment-management division.

Amaranth didn't register with the SEC. Tim Schnurr, an Amaranth employee, wrote in a letter to the SEC in 2004 that ``the hedge fund industry is a shining example of American free enterprise. Please do not try to fix something that is not broken.''

Edward Lampert's ESL Investments Inc., which had $15.5 billion under management as of July 1, Cerberus Capital Management LP, with $11.6 billion, and Soros Fund Management LLC, with $10.1 billion, also never registered.

Cox said in August that the SEC decided not to appeal the court ruling because it didn't expect to win.

``Hedge funds can now de-register and feel comfortable that they are not specifically going against the word of the chairman,'' said Ross Intelisano, a lawyer at Rich & Intelisano LLP in New York who represents hedge fund clients.

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