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*TESTIMONY OF  
ATTORNEY GENERAL RICHARD BLUMENTHAL  
BEFORE THE BANKS COMMITTEE  
FEBRUARY 25, 2010*

I appreciate the opportunity to support House Bill 5053, An Act Concerning Transparency and Disclosure.

This legislative proposal requires hedge fund investment advisors to disclose to investors and prospective investors any conflict of interest that may impair the advisor's duties and responsibilities to the fund or its investors.

Hedge funds inhabit a regulatory black hole but their integrity is critically important to our country's economy. Increasingly, retailization of hedge funds means that ordinary investors -- no longer only wealthy, sophisticated ones -- have a material stake in them. So do charitable institutions, school endowments and pension funds. Hedge funds account for a huge proportion - some statistics say about one half -- of all trading on major exchanges. And as we have learned to our sorrow, they use leveraging and debt devices that raise both their sway and susceptibility in market shifts. They are also activist shapers of corporate strategy and management.

The challenge is to achieve greater accountability and disclosure -- appropriate investor protections -- without stifling or impeding their contributions to market efficiency and capital accumulation.

Federal measures are preferable and should be sought through Congressional action. National standards and rules are appropriate because federal agencies have the resources and expertise as well as the authority to make enforcement effective. Only if Congress fails to fill the gap should states act. Potential state action is an impetus for federal initiatives. State action is not an optimal solution.

The trend toward increasing transparency is inevitable. As hedge funds themselves raise capital in more conventional ways -- going public, selling bonds and unsecured securities -- they must play by rules requiring disclosure. Any conflict of interest ought to be disclosed to investors who are often placing significant funds at risk.

In addition to the disclosure of conflicts of interest as contained in House Bill 5053, the committee should consider requiring adequate, accurate transparency as to how much risk, and in what forms, an investor can anticipate and whether controls exist to assure that risk strategies are

followed and internally enforced. Major litigation may materially affect a hedge fund's performance or change the risk of investing in that fund. A fund manager should, within 7 days of management's knowledge of such litigation, disclose such information in a manner similar to information that bondholders demand as part of any bond offering statement. Investor due diligence may achieve such disclosure for some but not all investors. Further, the fund manager should disclose to current investors on a quarterly basis the hedge fund investment strategy and philosophy.

Other considerations for the committee include the provision of an annual schedule of fees paid by the hedge fund, including management and brokerage fees, as well as the total amount of such fees and consultant contract fees paid during the previous year and any side letters that provide preferential treatment to some of the fund's investors.

House Bill 5053, along with these additional suggestions, guarantees hedge fund investors important information concerning their investment. Potential conflicts of interest must be disclosed as well as any change in investment strategy. Investors may wish to withdraw funds exposed to new, potentially greater risks.

I urge the committee's favorable consideration of House Bill 5053 and the additional suggestions outlined in this testimony.