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"The impact of Covid-19 pandemic and Brexit on Hedge Funds regulation "

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“The impact of Covid-19 pandemic and Brexit on Hedge Funds regulation”

Chapter 1

“Hedge Funds regulation”

1. Introduction…………………………………………………………………..5
2. Hedge Funds Organizational structure and Strategies………………………7
3. Compensation policies…………………………………………………….10
4. Regulatory provisions before Dodd-Frank act and AIFMD ………………..14
5. Regulatory provisions with Dodd-Frank act and AIFMD …………………17

Chapter 2

“Hedge funds regulation and strategies during COVID-19 pandemic”

1. Covid-19 impact on financial markets…………………………………….20
2. Hedge Funds response to COVID-19……………………………………….23
3. Regulatory response to COVID-19 consequences………………………...25
4. Hedge Funds future trends and strategies after COVID-19……………………30

Chapter 3

“Hedge funds regulation with Brexit”

1. Brexit impact on financial markets……………………………………….32
2. EU and Brexit regulatory divergence……………………………….....35
3. Financial service regulation under the UK-EU Brexit deal……………....37
4. Brexit Impact on Hedge Funds regulation…………………………......39
5. Conclusions………………………………………………………………41

Bibliography and Web references……………………………………...43

Abstract

The aim of this thesis is to analyse, and report impacts that Covid-19 pandemic and Brexit have driven towards Hedge Funds regulation and strategies.

As a matter of fact, several events have affected financial markets giving rise to a general awareness about the necessity to implement new sets of regulatory frameworks which can provide more transparency and disclosure to supervisory authorities.

Specifically, during Covid-19 pandemic, market irrationality and volatility has risen with a direct proportion to the increases in covid-19 cases forcing supervisory authorities to intervene in markets.

Moreover, in March 2020, short selling ban has been one of the main provisions adopted and which have been mostly criticised by hedge funds.

Indeed, the US Managed Funds Association, stated that the ability of balancing portfolios' risks along with the possibility to pursuit internal funds regulation can be jeopardized because of the short-selling ban.

In addition, Archegos family office bankruptcy highlighted another important issue regarding regulatory reporting.

As a matter of fact, the US family office circumvented 13F document by intentionally stipulating contracts which do not have to be disclosed inside the Security Exchange Commission compulsory document like the "total return swap".

Therefore, Archegos' failure for margin calls could not have been prevented by SEC for a lack of complete information.

On the other hand, GameStop Inc. case showed an opposite result which happened when Melvin Capital Partner Fund disclosed its short positioning on the 13F.

Indeed, as a result of this public disclosure, an internet group of amateur investors short squeezed the stock with the consequence of a significant loss for Melvin Capital Partners.

These relevant events open up to a great length discussion which tries to understand how to obtain proper alternative investment funds (AIF) regulation requirements increasing transparency and without incurring in a competitive advantage for AIFs by releasing private information strategies to public.

As far as Brexit is concerned, with the EU–UK Trade and Cooperation Agreement (TCA) it can be excluded a no-deal situation which could have been applied also to financial regulation.

On the contrary, the recent creation of the "Joint UK-EU Financial Regulatory Forum", marks a shared commitment for both UK and EU to comply with endorsed fights like anti-money laundering and economic or financial stability (Basel accords).

Notwithstanding this, there are still some obstacles that UK based Hedge Funds should tackle in order to operate like in the pre-Brexit situation which are, the EU delegation requirements and the declarations of ownership.

Chapter 1-Hedge Funds regulation

1.1 Introduction

The structure of this thesis is composed by three chapters where it can be found an introduction of regulations which is necessary in order to better comprehend their adequacy or lack in ensuring investors' protection and fair market competition.

Specifically, the first chapter will entirely be dedicated to Hedge Funds regulation.

In particular, there will be a description of an implementation of activities of transparency, financial marketing and disclosure that are recommended by Financial supervisory authorities from U.S and EU.

In the second part of the first chapter, regulatory framework will be distinguished among the most relevant acts issued post 2008 crisis, inasmuch many countries have encountered the necessity to regulate, with a separate method, financial intermediaries which have a relevant financial risk given by their risk-taking actions.

Thirdly, inside the second chapter, it can be found how merely Covid-19 pandemic has changed the way of operating of Hedge Funds.

Concerning the regulatory framework, the purpose of reporting recent financial market events during pandemic, will be to understand how this affected Hedge Funds transparency and disclosure.

In addition, it will be also considered which Hedge Funds strategies were put into motion in order to exploit market failures and volatility, which are consequences of the measures realized in order to maintaining high returns despite the real economy crisis of 2020.

Furthermore, future strategies description will be developed at the conclusion of third chapter looking for strategies adopted during pandemic which are going to become ordinary Hedge Funds practices after the lockdowns provisions as well.

Finally, In the last chapter, Brexit will be the protagonist of the topics tackled.

Moreover, a similar work of the second chapter will be fulfilled, focusing attention on differences with past and present regulations and strategies.

Additionally, with reference to recent events, it will be outlined a future possible outcome of Brexit on British financial markets, paying closer attention to Hedge Funds.

As far as Hedge funds are concerned, their history dates back 1949[1], when Alfred Winslow Jones, a sociologist and financial journalist, founded an investment vehicle which managed to overperform mutual funds. The reason stemmed from the fact that this peculiar new investment fund, used to adopt two different techniques that combined could generate higher returns than competitors, which are financial leveraging and short selling.

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[1] *Anson, Mark J.P. (2006). The Handbook of Alternative Assets. John Wiley & Sons. p. 36.*
This book traces the origins of the first real Hedge Fund giving authorship to Jones for having designed a new concept of investment vehicles.

In particular, A.W Jones & Co. fund used to long positioning over undervalued companies' stock and short selling overvalued companies, financing stocks acquisitions with the liquidity given by the short selling activity.

Over the course of time, Hedge Funds have gained notoriety raising in numbers and in capitals pooled. At the end of 60's, according to Carol Lumis[2], the number of Hedge Funds soared reaching the number of 166 and managing assets jointly worthing 2 billion of USD.

On the other hand, since the purpose of this type of funds is to gain as much profits as they can in the minimum time possible, they tended to be more exposed to risks.

Indeed, Hedge Funds have higher correlations with the market, tending to go bankruptcy easily when markets face bearish periods.

By way of proving this Hedge Funds tendence, it can be seen how from 70's, with the beginning of the oil crisis, the overall number of Hedge Funds plummet of about the 70%[3].

In the remaining 30%, it is noteworthy George Soros' Quantum Fund, which in 1992 managed to benefit from the fell of the British "pound" value managing to earn 1.1 billion USD in a month.

During 80's, renewed attention had been brought to Hedge Funds with a general market recovery.

In 90's and from the starting of the 21st century, Hedge Funds upswing stopped as a consequence of the dotcom bubble and the common trend of adopting more leverage transactions-based strategies.

Finally, in the last 20 years, exception made for the 2008 crisis years, there has been a sharp increase of Hedge Funds whose assets hit 3 trillion of USD in 2017 for assets managed[4].

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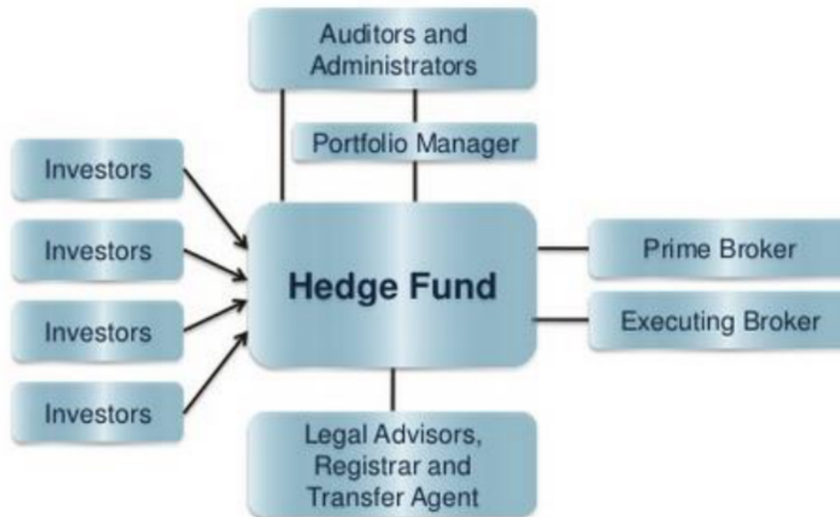
[2] Carol Lumis "The Jones Nobody Keeps Up with", Fortune Article, 1966

[3] Ineichen, Alexander (2002). Absolute Returns: the risks and opportunities of hedge fund investing. *John Wiley & Sons. pp. 8–21.* This source reports data from US Security Exchange Commission and other financial articles.

[4] Lindsay Fortado "Hedge funds regain lustre as assets hit record high", Financial Times, 2017.

1.2 Hedge Funds Organizational structure and Strategies

Before introducing the regulatory framework, it is important to describe the organizational structure of Hedge Funds and the several typologies of strategies.
The most widespread hedge fund organizational structure model it is composed of various subjects: The Management Body, the Administrator, the Prime Broker, the Auditor, and the Investors.



Source: "Hedge Funds and Other Private Funds: Regulation and Compliance" Thomson West, 2010

- The Management Body is in charge of undertaking strategic decisions and ruling the degree of risk exposition. It is also responsible for the creation portfolios, in order to make optimal investments with respect to the risk-return combination.

- The administrator is an external subject responsible for administrative activities and relationships with supervisory authorities. This figure is also in charge to compute the NAV on daily basis.

- The Prime Broker is an international level financial intermediary, coming from major financial institutions. Generally, it is a Broker-dealer[5]. The Prime Brokers plays the role of financier of the management company, granting credit lines and lending the necessary securities to give rise to short sales and directly acquiring suitable guarantees for the credit disbursed to the fund.

[5] Spiro, Rosann L.; Stanton, William J.; Rich, Gregory A. (2003). Management of Sales Force *McGraw-Hill/Irwin.*

- The Auditor has the task of checking the NAV[6] which can be defined as:” *the company's total assets minus its total liabilities*”. Regarding NAV, the U.S Security Exchange Commission states:” *Mutual funds and Unit Investment Trusts (UITs) generally must calculate their NAV at least once every business day, typically after the major U.S. exchanges close. A closed-end fund, whose shares generally are not "redeemable"—that is, not required to be repurchased by the fund—is not subject to this requirement*”.

The computation of Funds’ NAV is fundamental in order to establish the price that investors should pay for a given Mutual Fund or UIT.
Furthermore, Auditors’ additional role is to perform in accordance with standard accounting practices which can be US GAAP or the International Financial Reporting Standards (IFRS).
The last actors involved into the structure of a Hedge Funds are investors.
Hedge Funds’ investors are a particular category which have to observe several rules applied by regulatory framework. As a matter of fact, they are called: “accredited investors” which means that this qualification necessarily applies to “high net worth individuals” and subjects whose professional path justifies the will of investing into high degree of risk investments.
Hedge Funds performance depends on portfolio creation and management. Behind portfolio management and creation, there exist an investment process which is the result of risk management, due diligence, and expected return analysis. As far as strategies are concerned, it can be made a distinction between:

- *Directional strategy or Market Timing*, which consists of investing and disinvesting given a price forecast for a determined time.

- *Non-Directional strategy*, which consists of investing in pricing errors.

Directional Strategies involve different methods which try to speculate by forecasting the price of Stocks, Government Bonds, Currencies and Commodities.
The first method, which is also the oldest, is the “*Long/Short Equity*”. This method has been used by A.W Jones & Co. fund and consists of long positioning and shorting on respectively market winners and losers.
A variation has been applied to this first method, when funds manager decided to serve themselves just of the risky short selling method which has infinite potentiality in losses.
As an evidence of this, it is remarkable how a long position strategy can imply that in the worst of the case the value of a stock could reach the value of 0, in contrast, a short selling strategy could reach potentially an illimited value in stock when there will be the repurchase of that security.

[6] Glossary, www.Investor.gov, Net Asset Value definition

The second and the third methods which are “*Sector strategy* “and “*Emerging Markets*” adapt*” Long/Short Equity* “activity.

In particular, stock purchase will be realized in the event that, the net present value of profits cash flows is widely discounted compared to the intrinsic value of the company.

On the contrary, in a downturn market, managers make profits through the short sale of shares which are thought to be overvalued.

In “*Sector strategy*” method the whole process will be applied within a market sector where market values could be highly volatile.

In the “*Emerging Markets*” case, as the name suggests, the strategy will be adopted exploiting high growth potential of emerging markets[7].

The last example of Directional strategies is “*Global Macro*”.

“*Global Macro*” funds have large capitals which are invested following a macroeconomic ratio, namely a top-down analysis.

Managers of this category of funds employ large amount of money in any type of assets trying to open positions in the right moment anticipating trends.

The result of employing a large amount of money has a relevant impact on markets often expanded by the usage of leverage.

Non-Directional strategies, on the other hand, do not attempt to forecast predetermined securities, instead they attain various and single opportunities which could occur into the market.

The first method which is the “*Market Neutral*”, avoids the “*Long/Short Equity*” high exposure on the market.

As a matter of fact, “*Market Neutral*” funds managers hedge their entire long positions incurring in a significantly lower risk of loss and consequently a lower expected return.

In addition, a riskier version of this method is the: *“Merger Arbitrage*” where normal risk-adverse activities are interchanged with event driven (mostly takeover acquisitions).

Another renowned Non-Directional Strategy method is the “*Event Driven*”.

In this case funds buy the debt of companies that are in financial distress or have already filed for bankruptcy.

Finally, other categories are convertible arbitrage and fixed income arbitrage.

The first of the last categories consist of buying bonds and contemporarily short selling underlying stocks in order to benefit from the difference in price.

In conclusion, fixed income arbitrage as strategy it is implemented by funds when they buy and sell similar stocks or securities which are historically correlated and earning from the temporary price shifts in different markets.

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[7] Walker, Stephen (2010). Wave Theory for Alternative Investments. McGraw-Hill Companies

1.3 Compensation Policies

As indicated above, Hedge Funds capitals are raised among a restricted category of wealthy people who are conscious of this risky activity.

For this reason, the management body of these funds is responsible of successfully allocating significant amount of money inside the market, granting high returns regardless of the presence of a bearish or bulling market.

As correspondence of this effort, fees are applied following in most of cases the standard: "2 and 20"[8] rule. This standard fee arrangement charges a 2 percent of assets under management and the 20 percent of profits above a predetermined benchmark, such as, Libor rate or London interbank offering rate.

The effect of applying the "2 and 20" rule has been studied by Mark Kritzman in a research project called: "Portfolio Efficiency with Performance Fees"[9]. According to Kritzman, Investors expected return suffers from an:" *Asymmetry Penalty* "arising from the fact that, Hedge Fund managers tend to apply an additional fee when they outperform on the market.

On the other hand, when managers underperform, investors are not reimbursed, instead they still pay the 2 percent fee on asset managed.

Return and Risk Net of Fees

Alpha = 7%, Libor = 4%					
	No Fee	Base Fee	Multi Strategy	Individual Funds	Fund of Funds
Expected Return	11.00%	9.00%	7.71%	7.24%	5.52%
Downside Deviation	8.55%	8.55%	7.70%	7.70%	7.26%
Alpha = 8%, Libor = 4%					
	No Fee	Base Fee	Multi Strategy	Individual Funds	Fund of Funds
Expected Return	12.00%	10.00%	8.56%	8.10%	6.30%
Downside Deviation	8.55%	8.55%	7.64%	7.69%	7.20%
Alpha = 9%, Libor = 4%					
	No Fee	Base Fee	Multi Strategy	Individual Funds	Fund of Funds
Expected Return	13.00%	11.00%	9.40%	8.98%	7.10%
Downside Deviation	8.55%	8.55%	7.49%	7.63%	7.09%
Alpha = 10%, Libor = 4%					
	No Fee	Base Fee	Multi Strategy	Individual Funds	Fund of Funds
Expected Return	14.00%	12.00%	10.23%	9.83%	7.86%
Downside Deviation	8.55%	8.55%	7.71%	7.85%	7.23%

[10]

Furthermore, as the chart shows, performance fees tend to lower volatility but not risks, which can be seen by looking how expected returns (or risks) tend to rise even when downside deviation (or volatility) tends to lower. The consequence for Kritzman will be that investors will significantly reduce their long-term funds performance by investing into Hedge Funds compared to the past.

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[8] MARK HULBERT:"2 + 20, and Other Hedge Fund Math", New York Times, 2007.

[9] Mark Kritzman:" Portfolio Efficiency with Performance Fees", Massachusetts Institute of Technology in collaboration with Windham Capital Management.

[10] Mark Kritzman:" Portfolio Efficiency with Performance Fees", Massachusetts Institute of Technology in collaboration with Windham Capital Management.

Since Hedge Funds need to attract investors to enlarge their business and their profitability, in order to promise higher expected returns, managers will tend to pursuit a risk-taking attitude which can undermine the soundness of a risk management policy.
With the purpose of avoiding risk-taking activities, the Financial and Stability Board[11] principles and standards develop and promote the implementation of effective regulatory, supervisory, and other financial sector policies.

- Firstly, according to the first section, the board should oversee, and senior management should implement compensation system which promotes a compliance with laws, regulation, ethical issues, and internal conduct standards.
  This first article suggests that firms should have their internal definition of misconduct based on values, characteristics and business that promote ethical standards. In addition, the ultimate responsibility for ensuring accountability lies with Board of directors. BOD is also accountable for promoting business practices as well as prudent risk-taking behaviors involving senior management to design a compensation system which effectively delineates how compensation tools address misconduct risk.

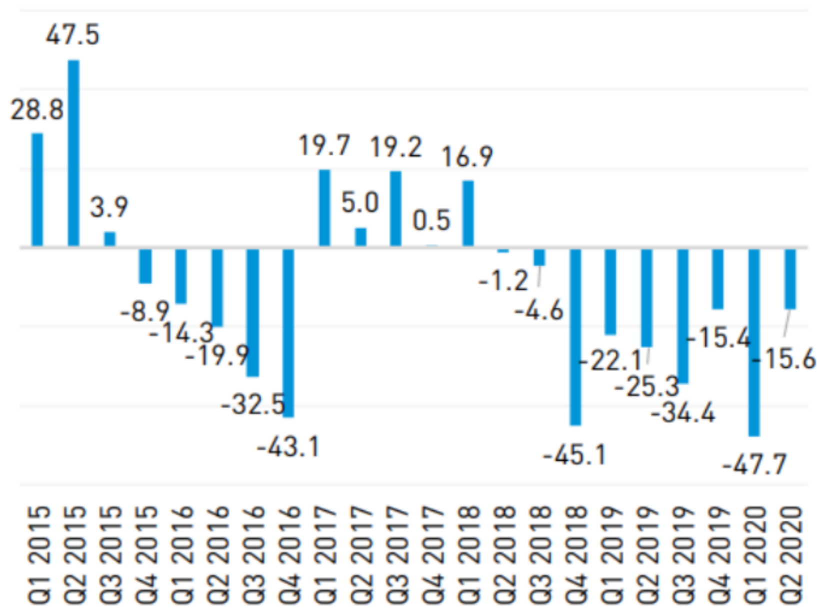
- Secondly, as FSB states:" *compensation should be adjusted for all types of risk, including difficult to measure risks. These include risks associated with misconduct that can result in harm to firms, customers, and other stakeholders. The processes for managing misconduct risk through compensation systems should include, at a minimum, ex ante processes that embed non-financial assessment criteria such as the quality of risk management, degree of compliance with laws and regulations and broader conduct objectives of the firm, including fair treatment of customers, into individual performance management and compensation plans at all levels of the organization and as part of the broader governance and risk management framework*". This last supplementary guidance suggests boards and senior management to include non-financial measures of performance which means to consider risks of any kind to be used in order to adjust compensation plan.

- Furthermore, according to standards 4 and 5, firms with large capital impact should consider all costs and quantities of liquidity and also of the financial for the esteem of the compensation pool.

- Additionally, standards 6 states that senior management compensation package should be variable depending on the individual performance.

[11] Financial Stability Board:" Supplementary Guidance to the FSB Principles and Standards on Sound Compensation Practices the use of compensation tools to address misconduct risk" 2009 document with an implementation in 2017.

Finally, despite the fact that, Financial Stability Board recommendations over financial intermediaries link management compensation with historical performance, the following charts show how in the real market these rules are not always followed.



[12]

[12] STATISTA, Preqin Pro chart:" Hedge Fund Asset Flows", 2020

[13]

As a matter of fact, the first chart shows how from 2015 Hedge Funds performance have decreased until reaching a negative record level in 2020 with COVID-19, whereas the second show billionaire compensation packages that according to Niall McCarthy inside this STATISTA report have never been so high.

[13] STATISTA, “Hedge Funds Manager’ earnings”, 2019

1.4 Regulatory Provision before Dodd-Frank Act and AIFMD

In past, Alternative Investment Funds have never been regulated by a consistent number of Laws.
In addition, the existing regulatory frameworks for this category, which involves Hedge Funds as well, has always been limited to a few numbers of national articles.
However, after the 2008 crisis, the European Union has implemented a new regulatory framework in order to enforce the ability to mitigate risk exposition.
Among all the existing types of risks, these are indicated as the main criticisms drivers inside the existing risk mitigation models and codes of best practice:

- **Market Risk** which is the risk of incurring in losses given by market variables like prices or volatilities.

- **Liquidity Risk** happens when a given financial asset, security or commodity cannot be traded quickly enough in the market without impacting the market price. In Hedge Funds situation it can lead to an opportunity loss.

- **Credit Risk** is a risk which can arise from a default on a debt of a borrower failing to make the required payments. Government Bonds and many other actors can be eligible to be part of Hedge Funds portfolio[14].

EU was not the unique Government body to set a new regulatory framework.
As a matter-of-fact US increased the number of existing laws that had to discipline alternative funds.
As far as USA are concerned, before the Dodd-Frank act of 2010, Hedge Funds were disciplined by the Investment Advisers act of 1940[15].

The Investment Advisers act aims at disciplining individuals who advice investors and other market actors in exchange of a compensation.
It constitutes US response to stock market crash in 1929, and this act divides the types of investment company to be regulated, into three classifications:

[14] It is a striking example of Elliot Fund owning Argentinian Sovereign debt when Argentina faced default. In that particular case, Elliot Fund managed in 15 years to receive the payment of its "Tango Bond" from the Argentinian government with over 300% of debt interests. Kaja Whitehouse:" Argentina says 'Arrh, no!' to Paul Singer's $20 million demand for seized ship", New York Post, 2012. In this article there is a description of an episode of foreclosure proceedings from Elliot Fund on an Argentinian military navy.
[15] Investment Adviser act 1940, sec.gov.com

- ***Face amount investment company***: which is an investment company in the business of issuing face-amount certificates of the instalment type.

- ***Unit Investment trust***: is an investment company which is organized under a trust indenture which issues only redeemable securities and does not have a board of directors.

- ***Management company***: any investment company other than a face-amount certificate company or a unit investment trust, for example, Mutual Funds.

Furthermore, Investors act provisions addressed companies for requirements on filings, service charges, financial disclosures, and the fiduciary duties.
Finally, it has also provided regulation for accounting methodologies; recordkeeping requirements; auditing requirements; how securities may be distributed, redeemed, and repurchased; changes to investment policies; and actions in the event of fraud or breach of fiduciary duty.

In Europe as mentioned before, national laws used to be the unique set of rules that regulated over alternative investment firms with specifics codes.
In Germany, for instance, Alternative Funds have to ask for a special authorisation at the "Bundesanstalt für Finanzdienstleistungsaufsicht" which is the German Federal Financial Supervisory Authority.
Additionally, the regulatory framework for alternative investments in Germany is collected inside the *Kapitalanlagegesetzbuch or KAGB*, which is the German Investment Code.
KAGB transposes EU directives ant it is the subsequent act to[16]

- the Capital Investment Companies Act of 1957 (KAGG)[17]

- the German Investment Act of 2005-2013 (InvG)

Firstly, KAGG used to regulate the legal relationship between the investment company and the shareholders owned by the company.
Instead, The German Investment Act was a set of German regulations for alternative and mutual funds which aimed at promoting Germany as an investment fund, stemming the exodus of German-managed funds to other European heavens.

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[16] Frank Dornseifer, Thomas A. Jesch, Ulf Klebeck, Claus Tollmann (eds.). Damir Barac (revised by). AIFM-Richtlinie (Directive 2011/61/EU on Alternative Investment Fund Managers with respect to the KAGB-E) (commentary). Munich: Verlag C.H. Beck (2013)
[17] Brandenburg.de (German Federal State of Brandenburg official website)

In Italy, Hedge Funds legislation has been introduced by the Ministerial Decree n°228 in 1999[18] delegated by the art.37 of "Decreto Legislativo" n°58/98[19].
The aim of this regulatory provisions was to set general standards which could align all the types of investment funds with Italian managed funds.
For example, it fixed to 100 the number of investors for a determined Hedge Funds (rule abrogated) and set a minimum amount of investment which was 1 million and that today is of 500.000 EUR (d.m. 47/2003)[20].
Finally, the modification made by the Ministry of Economics and Finance Decree n°197 of 2010, allowed SGR[21] to create investment funds which could invest into financial products different from those established inside the 4th article "comma 2".
As a consequence of this Ministry of Economics and Finance Decree n°197, Hedge Funds like other alternative investment funds were allowed to operate with higher risk exposure.
Luxembourg, instead, being part of the European Union, has adopted EU Directive 2011/61.
Before, Investment Funds were governed by the Luxembourg law of 13 February 2007 which replaced the law of 1991.
The objective of 13 February law in 2007, was to re-define the legal framework for institutional funds and enlarging the distribution scope to accredited investors. Since Luxembourg is one of the first European states for number of registered investment funds, it is also noteworthy the tax-efficient regulatory regime for specialized investment fund or SIF which aims for a broader range of eligible investors[22].

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[18] Ministry of Treasury Decree n°228 in 24th of May in 1999
[19] Decreto Legislativo n°58/98 which issued the TUF (Testo Unico Finanziario)
[20] Art. 12, comma1, d.m. 47/2003 substituted the minimum amount in EUR for an investment in AIFs.
[21] Società Gestione Risparmio is the Italian definition for Asset Management Company.
[22]According to SIF law, Luxembourg managed funds have to pay only the 0,01% on the NAV.

1.5 Regulatory Provision with Dodd-Frank Act and AIFMD

As Mary Jo White[23] stated during the Managed Funds Association Outlook 2013 Conference held in New York, in future, Hedge Funds are going to face a new era of: "*Transparency and Openness*".
This statement has assumed that the new Dodd-Frank and Jumpstart Our Business Startups acts would have given more:" *dynamic change and moving from what some would say was a secretive industry, to a widely-recognized and influential group of investment managers*".
The reason stems from the fact that both of these two acts provide important changes into Hedge Funds industry:

- *The Jumpstart Our Business Startup act* has facilitated the access to capitals for companies. Furthermore, the SEC voted to lift the ban that prevented Hedge Funds, Private Equity, and other private investment funds from marketing their investment wide audience[24].
  As a matter of fact, Hedge Funds must file a Form D with the SEC at least 15 days before advertising begins, where failure to follow these rules will likely result in a ban from creating additional securities for a year or more.
  However, Hedge Funds are still allowed to collect capitals just from accredited investors and are also forced to verify if investors meet the standard requirements in order to fulfill the investment.

- *Dodd–Frank Wall Street Reform and Consumer Protection Act* is a United States federal law enacted in July 2010 as a response to the Great Recession, which made changes that affected all the federal financial regulatory agencies and almost all the entire financial services industry.
  As far as Hedge Funds are concerned, Dodd-Frank act eliminated the exemption of register requirements for alternative investment funds.
  In particular, the Title IV of the Dodd-Frank addresses for registration with the intent of broaden the requirements and the record-keeping for investment advisers.

Dodd-Frank act adds in its VI title another legislative response which is, the Volcker Rule.
Specifically, "Bank and Savings Association Holding Company and Depository Institution Regulatory Improvements Act of 2010," introduces the so-called Volcker Rule which prohibits depository banks from proprietary trading and to invest up to 3 percent of their tier 1 capital in private equity and hedge funds.

[23] Former Security Exchange Commission chair, from 2013 to 2017
[24] SEC Votes to Lift Ban on Hedge Fund Advertising, CNBC, the Associated press, 2013

In addition, according to the Volcker Rule, Banks do not have to enter inside transactions that involve Funds or Funds that are controlled by such Funds without disclosing to the regulating entity and assuring that there is not a conflict of interest.[25]

In Europe instead a new Directive has been introduced in 2011.
Indeed, Directive 2011/61/EU was born following the global market downturn of 2008 aiming at increasing transparency by AIFMs and assuring that the European Supervisors, European Securities and Markets Authority (ESMA) and the European Systemic Risk Board (ESRB) had the necessary information to monitor financial systems.
It is composed by 8 chapters:

- *Ch. I, General Provision*: Directives are applied to all EU AIFM to all Funds which own EU AIF and non-EU AIFM which market AIFs inside the European Union.

- *Ch. II, Authorisation*: AIFM must be authorised by the home state regulator from AIFs above the threshold of 100 million if the Funds use leverage, and 500 million if Funds do not use leverage.

- *Ch. III, Operating conditions for AIFMs*: AIF have to be named using a series of codes which include its national identification code, the Bank Identifier Code (BIC) and the Legal Entity Identifier code. Furthermore, AIFs have to operate with brokers and counterparts which are subject to a regulatory supervision and that have an organizational and financial capability to provide services to the AIFs. AIFMs must submit quarterly, semi-annual, or annual reports to their respective member state regulator as well as an annual report (financial statements, activities, and information about the total remuneration paid by the AIFM to its staff).

- *Chs. IV-V, Transparency requirements*[26]: Firstly, when AIFMs use leverage, the main requirement for AIFM is to disclose the weight of the leverage in respect of the own capital employed. Secondly, according to the Ch. IV, each fund can only have one AIFm which could also delegate functions to entities.
  To fulfil the reporting requirements, AIFMs must file an Annex IV report within 30 days of the end of the applicable reporting period, which is determined by the amount of an AIFM's assets under management.
  In particular, Annex IV report is a regulatory document comprising 41 questions, concerning fund's investment portfolios, exposures, leverage ratios, liquidity, and risk analysis.

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[25] Dodd-Frank Wall Street Reform and Consumer Protection Act, University of Cincinnati
[26] Eur-lex.eu offical website of European Union law

Finally, in chapter V, directive defines control when a company has 50% of voting rights.
The scope of this directive is to disincentive the practice of asset stripping[27] among Private Equity companies.

- *Chs. VI-VIII, Marketing, and passport*: Provided that Managers comply the requirement of the Directive, marketing is allowed.
  However, EU managers obtain the so called "marketing passport" which allows them to market their EU funds with investors in any EU member state.
  Non-EU managers have not this possibility.
  Despite the fact that this provision has caused several criticisms, non-EU managers can still be authorised under national private placement regimes.

In conclusion, even though, alternative investment funds regulation suffers from a considerable lack on provisions when compared to other similar financial intermediaries, both Dodd-Frank act and AIFM Directive, implemented important changes inside the AIFM industry.
It can be noticed, how older rules used just to regulate the relationships which occurred between the several actors of the financial industry, whereas the recent US and EU acts aimed at increasing the number of transparency and disclosure documents that can be supervised by the Supervisory Authorities.

[27] Asset Stripping is the acivity of purchasing an undervalued company selling all the assets at higher prices regardless of the company's future.

Chapter 2- Hedge funds regulation and strategies during COVID-19 pandemic

2.1 Covid-19 impact on financial markets

The impact of Covid-19 in global financial markets has caused a fall in stocks value.
As a matter of fact, the 2020 stock market crash reached levels which could only have been seen during the financial crisis of 2007-2008.
The beginning of the stock market crash can be traced back to the 20th of February in 2020, when selling began to intensify inside the markets causing severe drops.
One of the deepest drops which affected stock market crash happened on the 16th of March in 2020, indeed, many newspapers linked the event to the previous "Black Monday" of 2008[28].
The situation worsened when OPEC failed to negotiate a cut in crude oil supply in order to avoid oil prices to plummet.
In fact, with the lockdown provisions which significantly reduced the numbers of air travels and lead to a general economic shutdown, the demand of oil has fallen sharply.
In response to the fell in demand, many oil-producers countries like Russia or OPEC members tried to negotiate but failed when Saudi Arabia refused to reduce the amount of oil produced.
Subsequently, US stock market suffered from a general plunge in values which stopped after Saudi Arabia, Russia, Mexico, and OPEC countries managed to reach an agreement for the reduction in oil barrels production, one month later, on the 2nd of April[29].
The end of the 2020 stock market crash can be defined on the 7th of April in 2020.
Since then, markets began to bounce back to higher levels, with exceptions for countries which were harshly hit by the pandemic and were adopting extreme provisions.
The main characteristics that could be found inside markets during periods of stock market crash are:

- *High volatility*
- *Bonds hiking interest rates*
- *Stock value fell*

The first characteristic taken into consideration is *high volatility*.
In economics, volatility represents a statistical measure of a stock deviation from a set benchmark which could be depicted by an unexpected upswing or a downward price trajectory.
It is an established fact, that low volatility indexes can be found into a sound and stable market whereas high volatility markets show dangerous and irrational markets.

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[28] Martha C. White: "Black Monday: A year after historic market rout, Wall Street reflects on what it got right — and wrong". NBC news, 16th of March 2020

[29] John Defterios and Hanna Ziady:" Oil prices march higher as OPEC calls for emergency meeting on Monday", CNN business, 4th of March, 2020

With the spreading of the Covid-19 pandemic, investors' concerns have caused high volatility inside financial markets with a consequent sceptical attitude which led to market downturns.

Table 1

Confirmed cases and market volatility

Country	Confirmed cases on Feb/29/20	Confirmed cases on Mar/27/20	Std_Feburary	Std_March	Rank 01	Rank 02
US	68	101657	0.0069	0.0268	7	1
Italy	1128	86498	0.0083	0.0258	2	2
China Mainland	79261	81378	0.0098	0.0084	1	12
Spain	45	65719	0.0074	0.0234	4	3
Germany	79	50871	0.0073	0.0212	5	5
France	100	32964	0.0069	0.0221	8	4
United Kingdom	23	14543	0.0064	0.0198	11	6
Switzerland	18	12928	0.0067	0.0172	9	9
Korea, South	3150	9332	0.0069	0.0189	6	8
Netherlands	6	8603	0.0074	0.0192	3	7
Japan	241	1468	0.0065	0.0164	10	10
Singapore	102	732	0.0050	0.0159	12	11
Total confirmed	84221	466693				
Average Std.			0.0071	0.0196		

As the table shows, according to a research conducted by Dayong Zhang, Min Hu, and Qiang Ji from the Research Institute of Economics and Management, Southwestern University of Finance and Economics, China[30], there is a strong link between COVID-19 cases and Market volatility.
As a matter of fact, the increase in number of covid-19 cases results in an increase in the standard deviation of the reference market.

[30] Dayong Zhang, Min Hu, and Qiang Ji: "Financial markets under the global pandemic of COVID-19", Research Institute of Economics and Management, Southwestern University of Finance and Economics, China; School of Public Policy and Management, University of Chinese Academy of Sciences, Beijing. April 16th 2020

Secondly, in US, *Corporate Bonds* still before COVID-19 pandemic felt in quantity of the 10% in January, which symbolized how investors were aware that the previous excessive rise in debt access for companies graded just above the "junk", could bring to a collapse in a corporate debt bubble with the implication of a recession in the real economy.
Government reaction in US was to intervene inside the U.S debt market in order to buy corporate debt of companies which were downgraded to junk after the market turmoil events of March.[31]
Furthermore, the Federal Reserve Bank of New York announced that it would repurchase 1.5 trillion of USD in Treasury securities.
A similar way of responding can be seen in China with government directed banks that supplied loans to corporations to avoid defaults or job losses and in Europe with the European Central Bank announcing an 820 billion programme named the "Pandemic Emergency Purchase Programme" which is a bond-buying program on the heels of a Quantitative easing program.
Finally, as far as market stocks are concerned, as mentioned before, the decrease in stock market was a direct consequence of the strong period of uncertainty and of the lockdown provisions which became stricter as there was a crescendo in COVID-19 registered cases.

[31] Federal Reserve Board announces establishment of a Commercial Paper Funding Facility (CPFF) to support the flow of credit to households and businesses, Federalreserve.gov, March 17, 2020.

2.2 Hedge Funds response to COVID-19

Hedge Funds response to COVID-19 has been absolutely positive.

As an evidence of this, both KPMG and EY surveys about Hedge Funds describe AIF during pandemic as a resilient sector which exploited social distances in order to enhance data technology and automation processes.

Indeed, EY[32] 2020 Global Alternative Fund Survey shows how, according to investors, Hedge Funds performance has shined, outperforming expected forecasts especially during pandemic.

In addition, concerning the goals of the Hedge Funds, in order to better cope with the increasing in fees and investment costs, AIF managers are increasing assets managed.

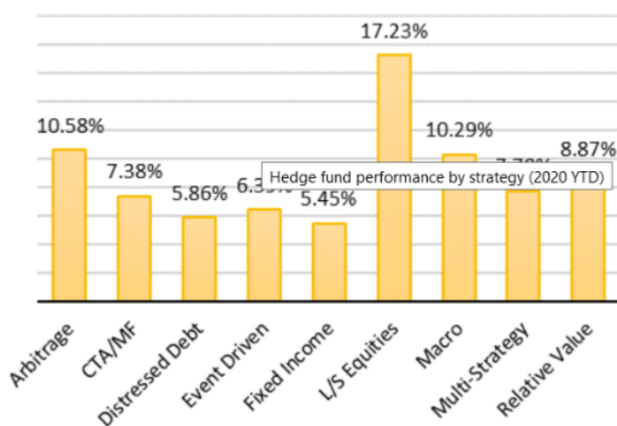
Moreover, technology and automation are the means by which AIFs are succeeding in improving performances and decreasing costs.

Since investors have not the possibility to meet physically Hedge Funds managers, they tend to prefer Hedge Funds which operate actively.

Finally, as it can be seen on KPMG's survey [33] future approaches will depend on central bank intervention, trying to mitigate risks and managing volatility.

In terms of performances, given the high volatility existing in many global markets was beneficial for Hedge Funds which managed to exploit investment opportunities and inconsistencies in markets that can generate extra returns for a portfolio.

Hedge fund performance by strategy (2020 YTD)



Source: Eurekahedge

The last chart[34] shows how during pandemic the most profitable Hedge Funds strategy has been the Long/Short Equity.

[32] EY, "In times of change, does accelerated adaptation present obstacles or opportunities?", 2020 Global Alternative Fund Survey

[33] KPMG International home. kpmg/hedgefunds2020Agile and resilient: Alternative investments embrace the new reality, 2020 KPMG/AIMA Global Hedge Fund Survey: COVID-19 special edition

[34] Market Views: Will 2021 be another big year for hedge funds? www.asianinvestor.net

As stated on AsianInvestor.com inside the Eurakhedge report[35]:" *Equity and event-driven strategies were beneficiaries of an acceleration of industry trends and corporate activity that have continued into 2021*".
Furthermore, technology ruled the landscape of the majority of sectors, dividing companies in those which managed to keep the pace with digitalization and those which did not choose to adapt to digital transformation.
This dispersive scenario created a boom for equity long/short strategies which succeeded in understanding which the market's chameleonic companies were able to adjust their strategies during pandemic.
On the other hand, quant strategies had to deal with the resizing of their models in order to better cope with COVID-19, which meant underperforming in respect to event-driven and equity long/short funds.

[35] Eurakhedge report on asianinvestor.net

2.3 Regulatory response to COVID-19 consequences

Additionally, to what concerns quant and general hedge funds strategies, the aforementioned strong market irrationality has become a new threat for Hedge Funds and legislators.

As a proof of this, on January the 27th in 2021, GameStop stocks listed at 17$ spiked at the price of 348$ causing huge losses to Melvin Capital Management fund which was short selling GameStop as a speculative measure originated from the retail gaming industry crisis.

In the specific, a reddit[36] group called "Wallstreetbets" discovered that Melvin Capital Management filed a 13F[37] form for the Security Exchange Commission where it had been stated that the fund had a short position on GameStop.

From that moment and for a non-specific reason, a vast majority of this digital group, which counts over 9 million of members or aspiring investors, started to "Short-Squeeze" the stock bringing it to unprecedent levels.[38]

Earlier in 2020, given that irrationality and volatility could not be ruled being investors' behaviours which outcome in a specific market situation, even if these are some of the main drivers of market instability, market rulers had to undertake several provisions aimed at protecting companies and investors.

For this given reason, when stock market crashed in March 2020, many government authorities responsible for regulating securities market (Austrian, Belgian, German, Greek, French, Italian, South Korean, Spanish, UK, and US)[39] imposed a ban on short selling.

[36] Reddit is a social platform which aims at offering a digital space for online communities of any type.

[37] "INFORMATION REQUIRED OF INSTITUTIONAL INVESTMENT MANAGERS PURSUANT TO SECTION 13(f) OF THE SECURITIES EXCHANGE ACT OF 1934 AND RULES THEREUNDER", SEC.gov

[38] Chart shows GameStop (GME) stock value in 6 months, google.com/finance

[39] CONSOB Press release, short selling, 18 May 2020

Consequently, this ban has been discussed at great length mainly by the US Managed Funds Association, which stated that the ability of balancing portfolios' risks along with the possibility to pursuit internal funds regulation can be jeopardized[40] because of the short-selling ban.

Nonetheless that global financial authorities wanted to assure the stability and integrity of the financial sector, according to a research study[41] conducted in 2011, after the 2008 crisis, found that there was no statistical evidence of a difference in excess return in stocks when short ban was applied and when it was not.

A result which signifies that there could not be a proven benefit from the disposition of a short selling ban provision.

Despite criticisms, FCA[42] and SEC, which were the regulatory authorities more involved into this debate, answered that the short selling ban was fundamental in order to maintain stability, integrity, and quality inside the financial sector especially during a pandemic.

Furthermore, FCA stated that there is no existing evidence that link the recent market fall to a short selling ban activity.

In addition, another critical issue that authorities are thinking to tackle during pandemic is the partial lack of enough Hedge Funds disclosure.

Indeed, in terms of regulations, as mentioned before, Hedge Funds are among the financial actors less regulated by financial authorities which are bound to provide information about their relevant positions and strong positions on companies.

The reason stems from the fact that documents which need to be provided to authorities like the U.S 13F or the E.U Annex IV, do not force AIFs to disclose all the owned financial instruments, as the scope of these documents is to ensure that funds are not investing investors' money with an excessive risky attitude.

The consequence of this regulatory gap is that Hedge Funds have the possibility to evade authorities' systemic risk monitoring by simply undertaking a risky position in derivative instrument which are not forced to mention inside the mandatory forms as managers are not directly administrating investors funds.

The phenomenon that has been explained is exactly what happened with Archegos bankruptcy.

As a matter of fact, Archegos choose to use swaps instead of common stocks to hide a huge position on Viacom CBS inc. avoiding being forced to disclose such positions[43].

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[40] Comments on Request for Comment on Earnings Releases and Quarterly
Reports (File No. S7-26-18), SEC, sec.gov

[41] Beber, Alessandro and Pagano, Marco, Short-Selling Bans Around the World: Evidence from the 2007-09 Crisis (August 19, 2011). Journal of Finance

[42] Financial Conduct Authority is the conduct regulator for 58000 financial services firms and financial markets in the UK

[43] Benjamin Bain, Joe Light, and Robert Schmidt: "SEC to Examine Fund Disclosure Rules After Archegos Blowup", Bloomberg, April 21, 2021

[44]

The effects of this circumvention perpetrated against SEC, caused the consequent bankruptcy of Archegos for margin call[45].

Furthermore, many investment banks faced relevant losses linked with the Archegos failure in margin calls. In particular, important banks which were doing business with Archegos like: Credit Suisse, Goldman Sachs, Morgan Stanley, or Nomura, revealed to have jointly reported 16 billion of USD of losses[46].

Subsequently to what has happened with Archegos fund, SEC wanted to enforce the level of transparency required to investment funds.

In fact, according to a recent Bloomberg article[47]:" *SEC is evaluating are whether filings should include derivatives and short positions, and if firms should submit 13Fs more frequently than every three months, said the people, who asked not to be identified in discussing internal conversations. An overhaul might help regulators and Wall Street spot risks that are building up in the financial system. The billions of dollars in losses that Archegos triggered for Credit Suisse Group AG and other firms show the consequences of having such blind spots*".

On the other hand, Hedge Funds express their concerns about new transparency measures.

More in detail, alternative investment funds are worried that, in future, they will have to reveal their strategies causing several issues like suffering from a consequent increase in competitive advantage, facing unattended implications in markets like the aforementioned GameStop case, or defending from target companies smear campaigns in case of a short-selling position.

Nonetheless, SEC is trying to revolutionize the way how 13F could be filled by companies.

Specifically, Last year, it proposed the 13F-1, in order to increase the threshold from $100million to $3.5 billion which imposes companies to disclose positions over it but encountering the opposition of Wall Street

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[44] Google Finance, VIACOM CBS Stock

[45] According to NY times: "Archegos Left a Sparse Paper Trail for a $10 Billion Firm", April 12, 2021, Archegos invested mainly in plain vanilla swap

[46] Elizabeth Dilts Marshall, Matt Scuffham:" TIMELINE-Diary of a meltdown: how the Archegos Capital fire sale went down", Reuters, April 2, 2021

[47] Benjamin Bain, Joe Light, and Robert Schmidt: "SEC to Examine Fund Disclosure Rules After Archegos Blowup", Bloomberg, April 21, 2021

which stated that with this provision it would be impossible for investors to understand where potential target companies have their positions and so discouraging them from investing.
Although 13F-1 might be unlikely to put into practice, there could be changes and implementations as well. For example, Jason Paltrowitz, executive vice president of corporate services at OTC Markets, claimed that: "*Rather than increase the reporting threshold for institutional investors, we think we should expand the definition or the number of securities that should be subject for reporting, namely OTC securities which are exempt from this whole thing altogether*"[48].
In Europe, during COVID-19, ESMA[49], underlines the necessity to force Alternative Investment Funds Manager to present a Legal Entity Identifier with EU authorities.
The issue reported by ESMA attains to the fact that constituting a Legal Entity Identifier it is compulsory in the home country for AIFM but not with European Authorities.
Since any country has their own code to identify a legal entity it is impossible for European supervisory authorities to cross-analysis and combine data under different reporting regimes.[50]
Secondly, ESMA proposed solutions aim at changing the regulatory contained into the Article 24 of the AIFM Directive, which limits the details to be reported on assets held by the AIFs to main instruments and categories of assets.
According to ESMA, this lack of details is detrimental for supervising and monitoring asset valuation.
In particular, ESMA proposal shall follow:

- Completeness in asset and liabilities information reporting
- Detailed information in counterparts and issuers
- Reduced transformation requirements to AIFMs
- International Standards
- Remove reporting of now duplicative items
- Information on the liabilities of the AIFs
- Other assets and liabilities

As far as UK is concerned, the FCA[51] directed firms to take all the reasonable steps in order to meet with their regulatory obligations.
First, FCA addresses for a correct and responsible asset management governance which is in contrast with the risk-taking attitude of AIF managers who tend to keep high rate of return even with instable market conditions.

[48] "SEC Proposed Big Change to Hedge Fund Transparency, But Wall Street Said 'No'", Spencer Israel, November 14, 2020, Yahoo Finance. Wall street refers to main actors from wall street itself like Nasdaq or Public Companies like FedEx or Alaska Air Group.
[49] European Securities and Markets Authority, EU financial regulator agency
[50] 18 August 2020 ESMA34-32-550: Review of the Alternative Investment Fund Managers Directive, to the attention of the European Commission
[51] FCA is the Financial Conduct Authority, a financial regulatory body in the United Kingdom

Secondly, FCA has modified the "*12-week rule*" in respect of senior managers to allow a replacement to stand in for positions for more than 12 weeks notifying FCA of this temporary extension.
Finally, the importance of FCA provisions and suggestions are of crucial importance in Alternative Investment funds landscape, since are the effective response that should be undertaken during pandemic, as such, in the light of Financial Conduct Authority recommendations, general FCA rules could be disregarded if AIF could not be following such for unattended events[52].

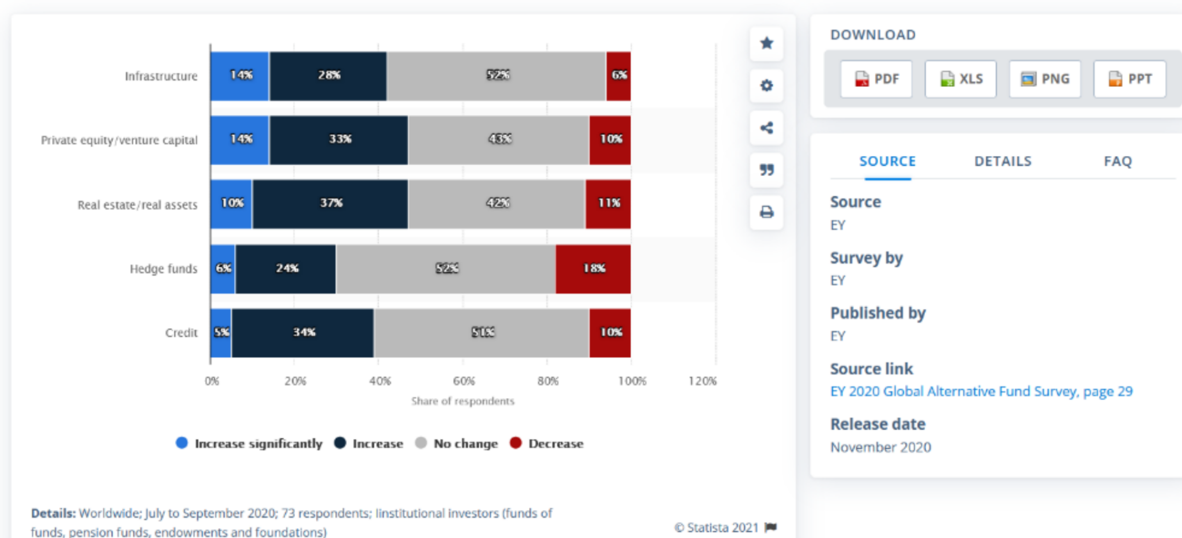
[52] https://www.fca.org.uk/

2.4 Hedge Funds future trends and strategies after COVID-19

As the British Alternative asset data provider Preqin states:" *The recent disruption has shown the industry to be highly adaptable and resilient in the face of massive market disruption. We are in the middle of an evolution where hedge funds that innovate and are flexible will become asset managers that succeed and grow. Looking out over the next five years, two significant thematic trends will dominate the outlook for the industry*"[53].

Trends which have been discussed in this analysis can also be found in other important and aforementioned surveys conducted by KPMG and EY, which are ESG and Technology.

The first thematic which is Environmental, Social and Governance is the cornerstone from where several sectors are about to base their futures strategies.



This chart displays how Hedge Funds are not considering ESG that much if compared with other alternative assets investors, since their only aim is to keep high return on assets also during COVID-19 pandemic.

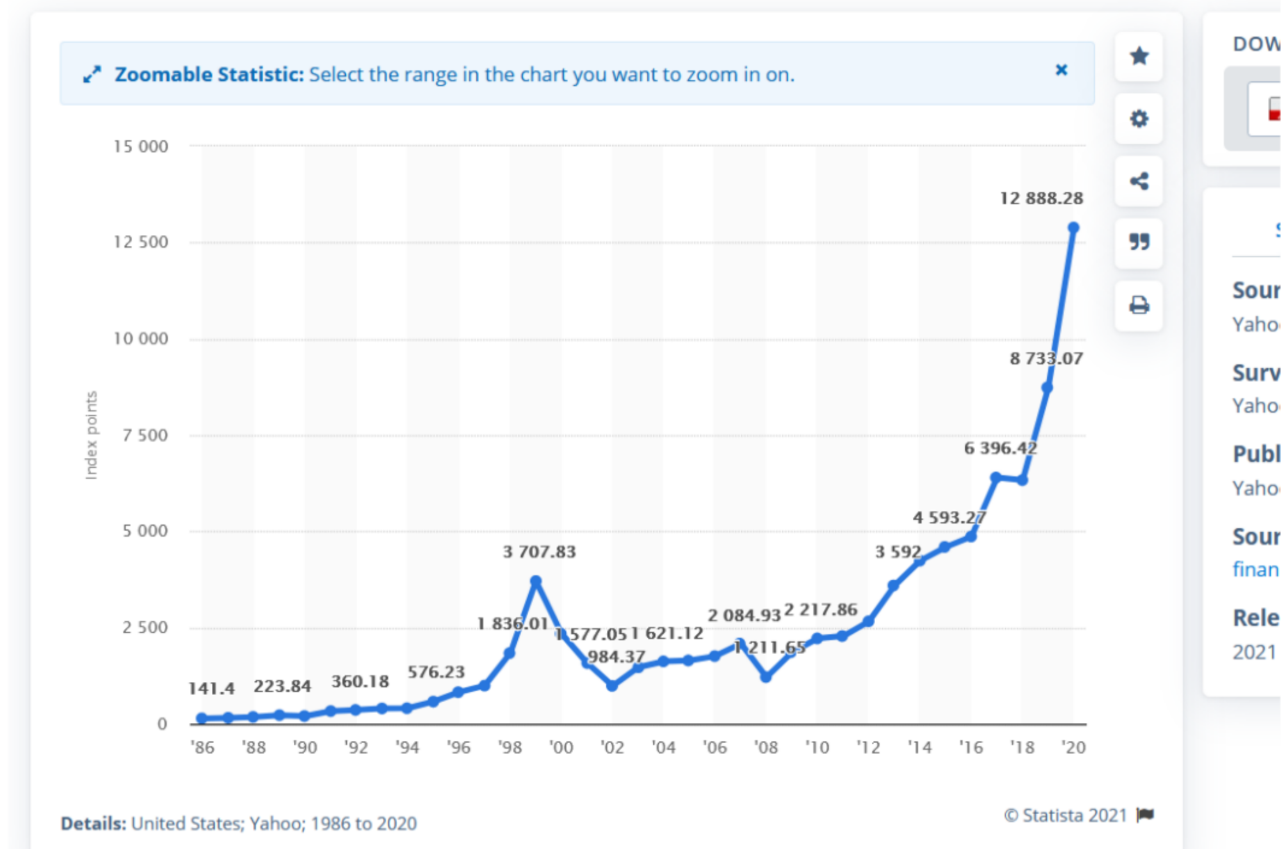
On the other hand, Policymakers are about to set relevant financial regulatory provisions and investors are increasing the will to invest in ESG Hedge funds or in Hedge Funds which are interested in this thematic. Hence, since as stated in chapter 2.2 Hedge Funds are increasing AUM[54] in order to tackle the increasing fees and investment costs, Alternative Investment Funds could adapt their strategies in order to attract investments from ESG interested investors.

As far as technology is concerned, it has been a disrupting factor inside not only financial markets but also for organisational aspects of hedge funds themselves.

[53] Future of Alternatives 2025: Hedge Funds: Embrace, Adapt, Prosper. Tom Kehoe, November 10th, 2020

[54]AUM stands for Asset Under Management

Annual development of the NASDAQ 100 index from 1986 to 2020



As the chart shows, NASDAQ-100 index which measures non-financial and above all tech-companies has seen a sharp rise reaching record-levels in terms of percentage of increase and in index points value.

Hedge Funds have exploited tech companies stocks in order to keep high returns over assets managed. Furthermore, according to KPMG survey on AIFM, technology has also affected hedge funds on organisational aspects.

Inasmuch, cyberattacks have been decisively increased since COVID-19 pandemic, forcing AIF managers to implement new technologies which detect and protect investors' data from phishing and email attacks.

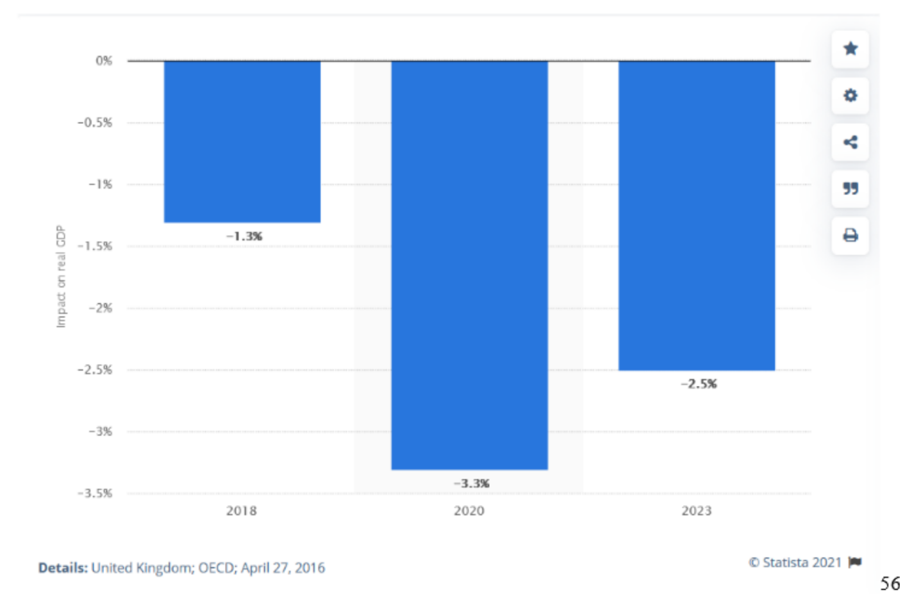
In conclusion, technology is a thematic which has a link also with regulatory provisions that have been discussed by ESMA, FCA and SEC about transparency and disclosure.

As the main purpose is to protect investors not only from the risk-taking actions in finance but also from the failure to observe principles of self-defending from treats which are increasing in a more digitalised world.

Chapter 3- Hedge funds regulation with Brexit

3.1 Brexit impact on financial markets

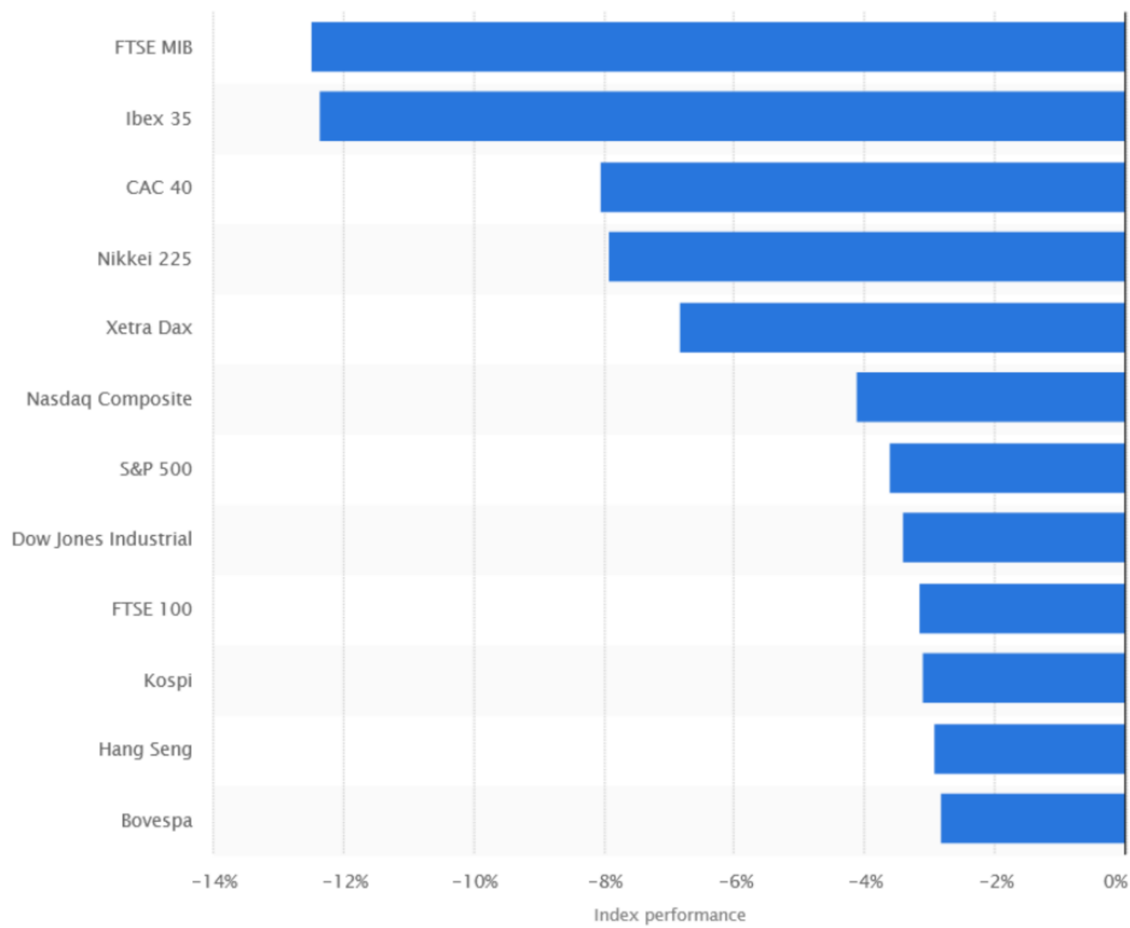
On the 30th of December 2020, EU and UK signed the EU–UK Trade and Cooperation Agreement (TCA) which govern the relationship between the EU and the UK after Brexit, providing for free trade in goods, transition of EU access in UK fisheries and UK participation in some EU programmes.
The relevant changes that have been incurred deny the free movement of persons, UK membership in the European Single Market and Customs Union, participation in most EU programmes, part of EU-UK security cooperation such as the access to real time crime data, defence and foreign policy cooperation, and the authority of the European Court of Justice in dispute settlement (except with respect to the Northern Ireland Protocol).
Additionally, impacts on financial sectors have been several, for example the number announced of company relocations from the United Kingdom (UK) in the finance sector which has resulted in the level of 10,000 banking jobs and 20,000 roles in the financial services industry[55] lost for the city.



[56]

Also forecasts conducted by the OECD showed how effects could be strictly negative for Brexit after leaving EU.
Despite expressed criticisms, Brexit had been announced on the 24th of June in 2016 causing several losses also among global markets.

[55] Dublin is Top Brexit Relocation Spot for Finance Firms, EY Finds, March 2, 2021
[56] OECD analysis of Brexit impact on GDP



[57]

Since the future evolution of Brexit, it is unknown, according to many academicians the outcome for British economy will not be positive.

Financial sector is not exempt from this prediction, on the other hand, United Kingdom's economists whish for bringing back its market volumes to equal and then higher levels by opening to other markets like (Canadian, New Zealand and Australian).

[57] Financialtimes.com/marketsdata, World markets at a glance, 24th June in 2016

Table 5.2. Assessments of 2030 economic impact of Brexit scenarios

Scenario	Organisation	Static (% of GDP)	Dynamic (% of GDP)
EEA	CEP (2016a)	−1.3 (N/A)	
	HM Treasury		−3.8 (−3.4 to −4.3)
	NIESR	−1.8 (−1.5 to −2.1)	
FTA	CEP (2016a)		−7.9[a] (−6.3 to −9.5)
	HM Treasury		−6.2 (−4.6 to −7.8)
	NIESR	−2.1 (−1.9 to −2.3)	
WTO	CEP (2016a)	−2.6 (N/A)	
	HM Treasury		−7.5 (−5.4 to −9.5)
	NIESR	−3.2 (−2.7 to −3.7)	−7.8 (N/A)

3.2 EU and Brexit regulatory divergence

On the 10th of February in 2021, Amsterdam surpasses London as Europe's top share trading hub with an average of 9.2 billion EUR that were traded on the Euronext Amsterdam.
This rise comes almost contemporarily to London fell to €8.6bn, dislodging the UK from its historic position as the main European financial market hub[58].
"*The shift was prompted by a ban on EU-based financial institutions trading in London because Brussels has not recognised UK exchanges and trading venues as having the same supervisory status as its own. Without this so-called equivalence to ease cross-border dealing, there was an immediate shift of €6.5bn of deals to the EU when the Brexit transition period concluded at the end of last year*" states the Swedish Chamber of Commerce[59].
As a matter of fact, European market provision is stricter than in the UK and will switch back to a more bank-based system when UK will officially be detached from EU financial directives.
Nonetheless, London and Brussels are willing to cooperate on financial markets exploiting differences in market structures.
For example, UK politicians view Brexit as a chance to restore power to watchdogs and to exchanges instead of giving more power to European regulators.
In addition, as it can be seen on a Financial Times article[60]: "*UK politicians want to give watchdogs greater leeway to write technical policy; exchanges and trading venues may also have greater freedoms in policing their users and products, according to a Lords Committee reviewing the future of UK-EU relations*".
Concerning the anti-money laundering laws, United Kingdom has implemented The Fifth Money Laundering Directive (5AMLD), which introduces a number of key changes granting: more transparency for the effective owners of legal entities, more access for European supervisory authorities to information, increase in tackling terrorism financing, higher access to cooperation between ECB and Supervisory authorities, extension to stricter financial checks with third countries with low anti money laundering regulation system.
However, UK has not transposed The Sixth Money Laundering Directive (6AMLD), justifying that it has already rules which comply with the 6AMLD.
It is noteworthy that, this European rule punishes persons who failed to avoid any money-laundering practices, whereas UK regulatory provisions applies its punitive practices just to individuals which "failed to prevent" from the undertook of these actions.

[58] "Amsterdam ousts London as Europe's top share trading hub", Philip Stafford, Financial Times, February 10, 2021
[59] "Amsterdam ousts London as Europe's top share trading hub", Swedish Chamber of Commerce, February 10, 2021
[60] "UK and EU begin diverging on financial regulation after Brexit", Financial Times, Philipp Stafford, March 26, 2021

This slightly difference caused a debate into financial industry between those who blame UK to be too soft in punishing individuals who launder money and so encouraging dirty money inflow into their financial system.

Notwithstanding the truthfulness of these charges, UK seems to set its sights to European anti-money laundering provisions making clear that there is a will to cooperate with Europe for AMD thematises.

3.3 Financial service regulation under the UK-EU Brexit deal

The aforementioned EU–UK Trade and Cooperation Agreement (TCA), disciplines the future relationship between UK and EU among mutual interest contents.
Although both of the parties managed to arrange an agreement, which is significantly important for trade and diplomatic purposes, financial services are not addressed with a notable length or substance.
As an evidence of what abovementioned, one of the main treats UK had to tackle in order to keep on operating with financial services in Europe even after Brexit, was the "*Passporting*"[61] requirement which is normally given to firms registered in the European Economic Area (EEA).
The result will be that companies could still operate if both EU and UK manage to address through unilateral declarations of equivalence, for matters of access in financial services, under existing equivalence regimes contained in U.K. and EU law and through domestic laws as well as any new ones that might be introduced. For instance, as stated in chapter 3.2, EU and UK still want to share a common path towards anti-money laundering fight and Basel pillars.
However, beyond this, it is important to mark what financial aspects the TCA includes:

- "*Best endeavours*" commitment to implement international standards (Financial Stability Board, Basel Committee on Banking Supervision, the International Association of Insurance Supervisors, the International Organisation of Securities Commissions, the Financial Action Task Force and the Global Forum on Transparency and Exchange of Information for Tax Purposes of the Organisation for Economic Cooperation and Development)

- A commitment to adopt the same licencing for newly established or expanded financial services from the U.K. into the EU (or vice versa)

- U.K. and EU self-regulatory organisations, including exchanges and clearing houses, are required to admit financial services suppliers from the U.K. and EU on a non-discriminatory and "*most favoured nation*" basis

- Access to U.K. and EU payment and clearing systems

[61] Passporting rights are established by the MiFID and MiFID II regulatory provisions and allow companies which are registered into the European Economic Area (EEA) to obtain an authorisation to operate inside all the EEA territory with the approval of just one of the single members state.
Without this authorisation is more difficult for foreign companies to EU to provide these services.

- A "*prudential carve out*," allowing both sides to impose financial regulations in the area of regulatory capital and related prudential areas limiting this carve-out when its usage would violate other provisions of the treaty

- The possibility to any of member states to regulate branches of U.K. firms on a national basis. U.K. law sector-by-sector peculiarities in their financial services laws or residency requirements are preserved

- Financial data transfers will continue to be active and be considered as relationships between members of the same Union

3.4 Brexit Impact on Hedge Funds regulation

The TCA agreement has avoided the necessity to apply World Trade Organization standards in financial markets for EU and UK.

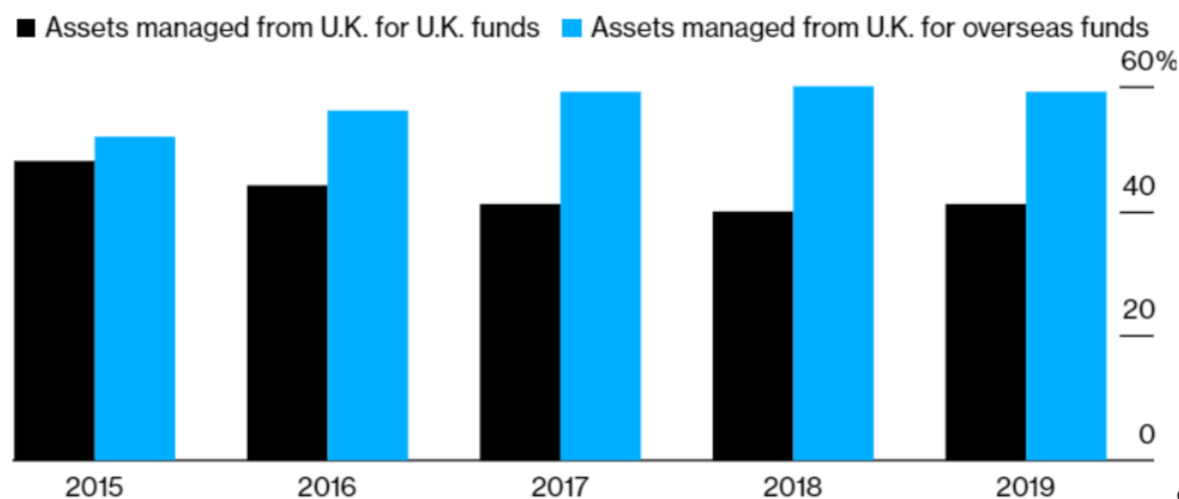
Moreover, markets reaction is going to be bullish for both UK and EU, as there is a hope that both parties will certainly maintain stable agreements and growth together without trying to destabilize and bring unfair competition to the other's situation.

However, in the first months of 2021, European Securities and Market Authority's proposals to change delegation rules had caused instability in diplomatic relations as it could enhance dislocation in global asset management ecosystem.

For the sake of completeness, it is important to mark how many Alternative Investment Funds operate in EU members states, especially Ireland and Luxembourg, with dislocate entities which means that the management operates from their home country outside the European soil and fund domicile.

This proposal has originated from the concerns of ESMA in regards of funds which hold considerable number of stocks in strategical European firms.

The consequence for AIFs and for Hedge Funds in particular will be causing managers to move more activities within the EU.



[62]

For Hedge Funds operating from UK this is one of the problems to be faced, since it is noteworthy to say that many of the Alternative investment funds which are established in UK are actually offshore funds which choose to settle their entity outside UK for lower jurisdictional standards and fiscal charges.

[62] "London Fund Managers See Post-EU Threat to $2 Trillion Business", Bloomberg, Lucca De Paoli, and Silla Brush, 15 January 2021

For this given reason, with UK adapting its regulatory provisions in order to better attract funds and to keep on operating in EU, offshore funds will have double obstacles to overcome with FCA and EU supervisory authorities approval.
Although at first glance, it seems that UK could have had to face treats in obtaining recognition from EU for its financial law to be compliant with EU perspective, on Friday 26 March in 2021, UK government confirmed that the "*Joint UK-EU Financial Regulatory Forum*" will be created.
This forum aims at shaping a voluntary regulatory cooperation which is comparable to what the EU has in place with the US and Japan[63] substituting in facts, the lack of financial regulations observed into the TCA agreement.
One of the most realistic scenarios has been analysed by a Legal research paper of Oxford University[64] where it is stated that:" *the economic incentives of both the UK and of the EU27 are strongly in favour of maintaining Single Market access for financial services. Political considerations also push the two sides into this direction*", this will happen since:" *In a comprehensive assessment, consultancy firm Oliver Wyman comes to the conclusion that a UK exit from the Single Market could jeopardise 40-50% of EU-related activity (approximately £18-20 bn in revenue) and up to an estimated 35,000 jobs, along with approximately £3-5 bn of tax revenue per year*".
What has been reported has the purpose to point out that EU and UK both have the common interest in keeping UK in the European single market access.
All this results in the description of a probable scenario where the EU will undoubtedly subtract financial quotas from UK, including Hedge Funds and AIFs industry, but the other side of the coin the UK financial intermediaries so Hedge Funds as well, will keep on operating from United Kingdom without being completely cut off from European markets and instead exploiting the future regulatory discipline that UK will adopt which could fit better for them.

MiFID II	Directive 2014/65/EU on markets in financial instruments
Short Selling Regulation	Regulation (EU) 236/2012 on short selling and certain aspects of credit default swaps
SFT Regulation	Regulation (EU) 2015/3565 on securities financing transactions reporting
European Market Infrastructure Regulation	Regulation (EU) 648/2012 on OTC derivatives, central counterparties, and trade repositories ,including the Regulation's margining, risk mitigation, and clearing requirements relating to over-the-counter (OTC) and exchange-traded derivatives, and accompanying regulatory technical standards

Finally, it is important to underlying which European regulation applying to date to hedge fund managers in the United Kingdom, which are still relevant for UK in order to walk in a common path.
The reason in this case stems from the fact that if UK complies with a regulatory framework which is similar to the European developments of the rules illustrated in the picture, UK will still operate inside the single European market as it has always been allowed to third countries like US or Japan, to greater reason if it can be considered the creation of the "*Joint UK-EU Financial Regulatory Forum*".

[63] UK and EU reach financial regulation deal in breakthrough on co-operation, Jim Brunsden and Peter Foster, March 26, 2021
[64] "The Irrelevance of Brexit for the European Financial Market", Wolf Georg Ringe, University of Oxford, 2018

3.5 Conclusions

In conclusion, Covid-19 pandemic and Brexit have caused several events of market uncertainty and mistrust.
Reasons can be detected from a general concern that happens where there is not a clear vision for how it will be the outcome of these situations.
As far as Hedge Funds are concerned, Covid-19 has marked the importance to better monitor the risk assessment that Supervisory authorities have to conduct towards Alternative Investment Funds.
In particular, the Archegos event has witnessed how the lack of a proper and detailed documents requirement resulted in an intentional circumvention of regulatory provisions in order to undertake more risk-attitude investments.
Nonetheless of this, Hedge Funds expressed their fears in disclosing with a more detailed transparency their strategies as it could lead to an increase in market competition by investors who could have an easier access to more detailed official forms.
As an evidence of what stated, after that Melvin Capital Hedge Funds disclosed SEC their short positioning on GameStop inc. a group of non-professional investors short squeezed the same stock, as a sort of protest against financial markets, and all of these incurred in a significant loss for the hedge funds which had an opposite position.
Undoubtedly, there is a common need for both supervisory authorities and hedge funds, to safeguard AIFs investors and financial markets by overseeing Hedge Funds industry transactions claiming more disclosure and transparency without jeopardize their efficiency by publishing their personal information and strategies.
Concerning the Brexit case, it is noteworthy how the EU–UK Trade and Cooperation Agreement (TCA) has excluded the possibility for both EU and UK to close trade relationships among both of the parties.
As a matter of fact, the TCA agreement makes possible for European Union and United Kingdom to trade goods freely with no barriers.
However, financial services have not been disciplined with a notable length inside the agreement casting a shadow on the future of financial relationships between these two actors.
Notwithstanding this, recent studies state how EU and UK cannot renounce to cooperate into the modern financial scenario, for economically and strategically purposes, which means that UK will still adopt almost coincident regulatory provisions to European directives and will benefit from a probable future financial access inside EU.
The result of what stated establishes that Hedge Funds from UK will probably encounter some difficulties in accessing the single European market, but, on the other hand, there will be no particular differences since European Union already grants to third parties like US and Japan, which have complementary standards, to operate inside the EU members state financial markets.
To sum up, Brexit will not bring relevant treats for Hedge Funds regulation, in fact, according to the TCA, UK and EU will jointly commit for tackling anti-money laundering and for aligning on accounting standards and general supervisions.

On the other hand, from an economical point of view, Brexit will be beneficial for Hedge Funds in Europe which could exploit this situation by enlarging their market quotas and for UK based AIFs that in future will have the opportunity to access into new markets like (Canadian, Australian, and New Zealand).

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