

OPINION

of the

BUNDESVERBAND ALTERNATIVE INVESTMENTS (BAI e.V.)

on

**CESR's Issues Paper "Can hedge fund indices be classified as
financial indices for the purpose of UCITS?"**

(Dated October 2006; Ref: CESR/06-530)

General Remarks

All comments made below refer to so called composite investable hedge fund indices if not specifically mentioned otherwise. Most critical studies regarding hedge funds refer to non-investable indices, though. Non-investable hedge fund indices are not relevant for the discussion, since products based on them can usually not be realized due to the non-investable content ("closed funds") of many such indices. They are also not helpful as investment benchmarks, since they cannot be replicated. The criterion "investable" is also applied to most other financial indices without necessarily being mentioned since usually only hedge funds do not accept additional money (i.e. closed), if they do not expect to generate enough return for the new investors or dilute the returns for existing investors. This should be viewed as a positive criterion of hedge funds, which is inter alia to be attributed to the often high financial commitments of hedge fund managers to their funds and the fact, that they usually only earn significant income, if the fund generates performance above the hurdle rate and the high water mark.

Hedge fund indices should not be treated differently from other financial indices. UCITS already have access through various indices or derivatives thereof to exposures, which they may not be able to acquire directly. The German Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin) for example announced recently that derivatives linked to commodity indices are eligible assets for UCITS as long as the index complies with the diversifications rules set forth in the Working Document ESC/13/2006. According to BaFin the Dow Jones-AIG Commodity-Index complies with the respective index requirements. So the latter fact cannot be an argument to prevent hedge fund indices, which fulfil the financial index criteria, to be treated differently from other indices. Access to hedge fund indices would allow UCITS to become even more diversified and thus reduce the investment risk for investors and it would also make it easier for them to generate absolute positive returns. A UCITS investing only in hedge fund indices - if it finds enough good indices and index derivatives issuers to fulfil the UCITS diversification requirements - would result in a very diversified low risk portfolio and would in no case be able to show similar risk as single hedge funds. It may be similar to diversified average funds of hedge funds, though, which show very low risks (see table below), but could not be actively managed in our opinion.

Unfortunately the paper "Hedge fund indices for retail investors: UCITS eligible or not eligible" of *Francois-Serge Lhabitant* does not sufficiently take into account the important differences within investable hedge fund indices, and especially not the differences between managed account based indices (which by construction are expected to provide less returns than other investable indices, since the index constituents are more liquid and there is an additional layer of platform fees) and other investable hedge fund indices (see attached table below). Not all investable

indices need to be based on managed accounts. Some investable index providers (e.g. FTSE) do the constituents selection first and then negotiate with the funds the opening of a managed account. And finally - it should be the UCITS themselves, who have to decide, if a specific investment is attractive or not.

Index Concept	Name of Index	Inception	2002	2003	2004	2005	2006 YTD	Vola (p.a.)	Max. Drawdown	% Pos. Months	Corr. MSCI World	Corr. Lehman Aggr. Bd.
Investable Indices (based on Managed Accounts)	HFRX Equal Weighted Strategies Index	04/2003		8.5 %	2.8 %	1.3 %	4.6 %	2.9 %	-2.4 %	67 %	0.83	0.18
	S&P Hedge Fund Index	10/2002	1.9 %	11.1 %	3.9 %	2.8 %	4.7 %	2.6 %	-2.2 %	74 %	0.46	0.22
	MSCI Hedge Invest Index	07/2003		4.4 %	3.2 %	4.7 %	3.3 %	3.0 %	-2.3 %	74 %	0.78	0.00
	FTSE Hedge Global Index	07/2004			1.1 %	2.6 %	4.0 %	3.0 %	-1.8 %	67 %	0.87	-0.22
	Average	01/2003		8.0 %	3.3 %	2.8 %	4.2 %	2.9 %	-2.2 %	70 %	0.73	0.04
Investable Indices (based on Offshore funds)	ARIX Composite	01/2002	1.5 %	11.5 %	4.4 %	9.4 %	8.4 %	3.1 %	-1.8 %	74 %	0.53	0.05
	Credit Suisse - Tremont HFI Investable Hedge	08/2003		4.3 %	6.2 %	4.5 %	6.1 %	2.8 %	-1.7 %	68 %	0.79	-0.02
	Average	01/2004			5.3 %	6.9 %	7.2 %	3.0 %	-1.7 %	71 %	0.66	0.02
Fund-of-Funds	HFRF Fund of Funds Composite Index	01/1990	1.0 %	11.6 %	6.9 %	7.5 %	4.8 %	3.6 %	-2.7 %	72 %	0.65	-0.01
Non-investable	HFRF Fund Weighted Composite Index	01/1990	-1.4 %	19.5 %	9.0 %	9.3 %	7.1 %	4.8 %	-5.7 %	74 %	0.83	-0.15
• All data is USD (gross). In case any monthly index calculation fees are reported by the index providers they are added. • ARIX Composite Index consists of equally weighted ARIX Relative Value, Event Driven, Equity Hedge and Tactical Trading • Investable Indices Average consists of equally weighted monthly data (since inception, where available) of the CSFB/T, HFRX, S&P, MSCI and FTSE investable composite indices. • S&P HFI - no official data since end of April 2006												

Table 1: Performance comparison of different types of HFIs. Data used is from the date of index launch till the end of September 2006.

Q1: What are your views on the potential biases described in this section and on how they can affect HFIs? Please explain your comments.

Generally the biases discussed here are only relevant for non-investable indices or for the “pro-forma” track record of indices before the date of their launch. The derivatives on hedge fund indices would need to have hedging (tracking) vehicles. If an index provider starts manipulating the past index performance by deleting defunct funds or backfilling the performance of newly added funds, then the issuer of the derivative would be confronted with an ex post tracking error (as he is not able to perfectly hedge himself) and he would have to carry the (normally negative) difference on his books. So the derivative provider would not like to work with such an index in the future. For example if a new fund is included in the index and through backfilling the past 12 months index performance is increased by 1%, then the issuer of the derivative would have to take a loss equal to the volume of the issue multiplied times 1% on his own book. Same happens if a bankrupt fund is simply taken out of the index, so that the derivative issuer will have an ex ante tracking error, as he would continue to hold the investment in the hedging portfolio. These effects are irrelevant for a “pure” investable index, which tracks real performance achievable by an investor under realistic (real world) conditions. But index providers in general – not only hedge fund index providers – should clearly state their index methodology and potential significant biases and especially should differentiate between theoretical pro-forma index results (usually taking the past performance of the funds selected on the launch date of the index, which often results in “too good” pro-forma index performance prior to launch date, since only index derivatives with good results can be sold) and real index results.

A) Database Biases

a) Different databases: As hedge funds are not publicly distributed, it is practically impossible to have all funds reporting to the same database. This is not a big problem for an index constructor, as several databases can be easily merged. The index sponsor can manually maintain the track record from funds that stop reporting, but are still open for investment, by receiving data from the fund or its administrator directly. As hedge funds within sub-strategies show high similarity of their co-movements like that of sector equity indices (with minor exceptions)¹, it is to be expected that there will be no substantial effect on performance on average. It is important that it is disclosed – but not necessarily to the broad public - which funds are covered in the universe (See also answers to Q5, Q12 and Q14).

¹ Cp. Amenc, Goltz (2006): “A reply to the CESR recommendations on the eligibility of hedge fund indices for investments of UCITS”, p. 15.

- b) Self-reporting bias: There are several aspects here. Firstly the fund may choose not to report to a database or index provider, because it has poor performance, which means that normally a potential investor would not be missing much on it anyhow. If the fund thinks it can perform better in the future it normally would report to the database at such a point in time. Secondly many of the best funds also stop reporting or do not report to databases at all, because they already have too many assets and have reached their capacity. There is no clear evidence if the self-reporting bias has a positive or negative impact on performance. And finally, if the funds of the second type are still open for investment, but do not report to commercial databases just to avoid further advertising, they still can be included in the index and report to the index sponsor directly.
- c) Database selection criteria bias: This can be handled the same way as in a) above.
- d) Backfill bias: This bias is only relevant for theoretical past pro-forma performance of an index (especially for a non-investable index). The bias in the database itself is only relevant for an investor assessing which funds to be selected for a future investment, and is in this sense very similar to the self-reporting and survivorship bias. These three biases are irrelevant for “pure” investable indices. (See also answer to Q7)
- e) Survivorship bias: This is a bias, which is inherent in any new index at inception, as well as with any new investment plan, portfolio, strategy or pro-forma track record. After the start of the index, defunct funds should not be deleted from the past track record. If the funds are still investable, they should be further kept in the index. If they are wound down, the losses should be part of the index performance (See also answer to Q8). The bias in the database itself is - similarly to the backfill bias - irrelevant for a forward-looking, continuous, “pure” investable index. It determines only the index composition at the index launch date (and inflates the “pro-forma” past track record), but has no effect on the future performance as long as the defunct funds are not just removed from the calculation.

B) Index Biases

- a) Sample bias: Many recognised financial indices have sample biases, especially if the universe, which they try to represent is not clearly defined (e.g. most “world” indices do not cover all countries or potentially relevant market segments worldwide). Investable hedge fund indices are usually based on a universe of all hedge funds for which the index sponsor has reliable data. Several index sponsors aggregate data from different commercial databases and in addition include other funds they are aware of. The database of the index sponsor may deviate due to the private placement nature of hedge funds, but traditional

financial indices also may be based on different databases. The so-called managed account based indices usually require hedge funds to open a managed account after the fund has fulfilled all other index criteria (see e.g. FTSE index process²). Therefore, usually, available managed accounts do not limit the sample of eligible funds but are the result of a structured index process.

Also, minimum quality requirements for hedge funds are needed and not untypical. Hedge fund indices are developed to be the basis for benchmarks for funds of funds – which all have quality requirements for their hedge funds – and products, which also should be attractive to potential investors. While for example stocks need to prove their quality before being allowed to trade on a stock exchange, non-traded hedge funds have to pass minimum quality (due diligence) standards. In this respect we recommend in order to protect investors that CESR should require hedge fund index providers to include some minimum quality standards for index components.

Hedge fund indices will usually follow rules and are characterised by rather low index component turnover and thus are significantly different from actively managed funds of funds. It is to be remembered, that some of the best performing managers also stop reporting to hedge fund databases, when they reach their capacity limits.

- b) Defunct fund bias: Removing components (defunct funds) going backward should certainly not be allowed for hedge fund or other indices, which qualify as underlying for UCITS products. Funds that stop reporting to a database, but continue to operate and are still open for new investors, should continue to be a part of the index (data can be further obtained from the fund itself or from its administrator).
- c) Classification standards: In a first step CESR may decide to allow only composite investable hedge fund indices as qualifying UCITS underlyings. Investable composite indices do not vary significantly (especially if, additionally to the return, volatility or other risk measures are applied and if same-period comparisons of real and not pro forma track records are used). Regarding classification, this is an issue also found in traditional (e.g. small cap equity) indices. Classification by the hedge fund index provider, independent from the hedge fund's own classification, may be a requirement for an eligible index. Mathematical clustering, principal component analysis, factor and regression analysis etc. are recognised tools for classification and can be verified by independent third parties and thus usually do not involve ongoing discretion by the index sponsor. Low correlation of certain strategy-specific hedge fund indices can usually be explained by studying the index definitions and can also be found

² See www.ftse.com/Indices/FTSE_Hedge/index.jsp

with traditional indices e.g. equity style indices (growth, value etc.). Also, e.g. commodity composite indices show much more heterogeneity than hedge fund composite indices.

- d) Index weighting: This applies to all kinds of financial indices. As long as the method is transparent and repeatable and stable, this should not be considered a negative hedge fund index bias. See also answer to Q4.

Q2: Are there any other material sources of bias affecting HFIs that CESR should consider?

No.

Q3: Should an HFI have to meet certain additional quantitative criteria other than level 2 requirements, or should compliance with the level 2 requirement of sufficient diversification be left to the UCITS to assess? Please explain precisely the grounds underlying your comments.

There is no reason why hedge fund indices should be treated differently from other financial indices. In general, hedge fund indices are much more diversified than commodity-based indices (many of them relying strongly on the oil price), some equity indices (e.g. in smaller countries relying very much on the largest companies) etc. It is not clear, why additional diversification rules should apply to hedge funds compared to other indices. If anything, studies show that about 15 hedge funds are sufficient for diversification of a composite index (see for example *Lhabitant, Hedge Funds Quantitative Insights*, 2004). Some traditional indices only contain few constituents like the DAX 30 and the top 25 companies in the S&P 500 account for 40% of the index.

Q4: What requirements on weighting should HFIs have to fulfil to qualify as financial indices? Please explain precisely the grounds underlying your comments.

No additional requirements compared to other financial indices should HFIs have to fulfil. The case could be made that the negatives of one weighting approach are positives of the other and vice versa. Additionally there are for example financial equity indices, which are acknowledged as financial indices and are using all kinds of weighting methodologies – price weighting (Dow Jones Industrial Average), asset weighting (S&P500), equal weighting (Willshire) etc.

Q5: Is the definition of the representative group of underlyings made by the index provider sufficient to satisfy the criterion of “adequate benchmark”? Please provide comments.

Hedge fund indices usually do not try to measure the whole hedge fund universe. From an investors perspective they should be compared to the universe of all hedge funds, which fulfil certain reasonable criteria. These criteria could be for example:

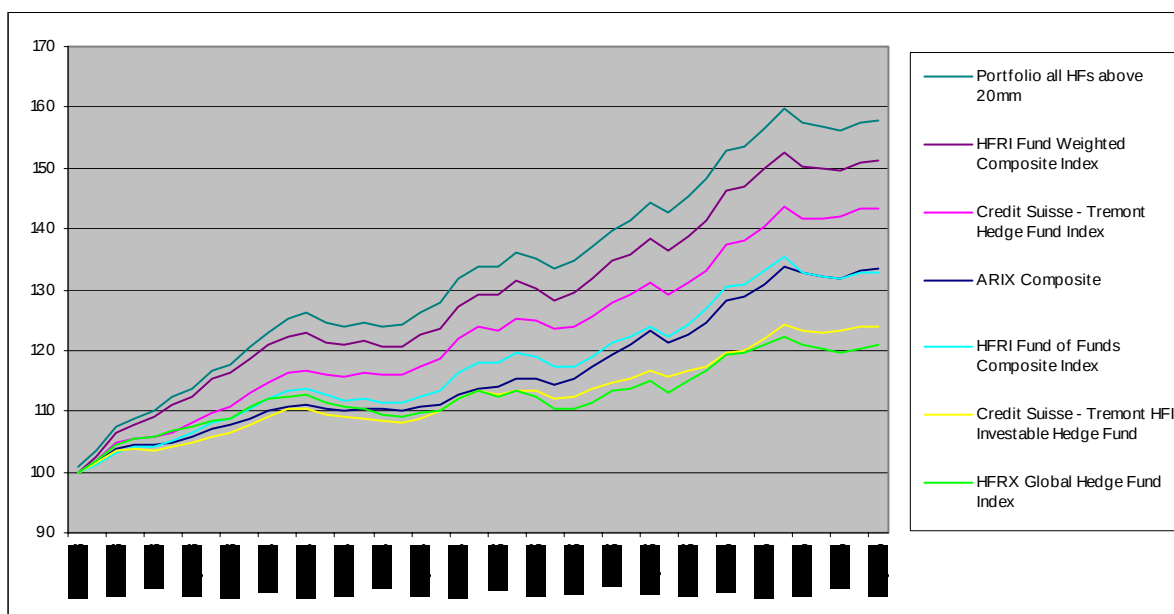
- a) Funds with a minimum size above e.g. USD 20 mm (this already includes about 65% of all hedge funds worldwide and approximately 95-98% of all hedge fund assets under management) and compares to similar universe definitions e.g. of all listed stocks worldwide.
- b) Funds open for additional investments.

In addition, investable hedge fund indices are seen as alternatives to hedge funds eligible for funds of hedge funds and therefore could be compared to the performance of fund of hedge funds indices. It can be shown (see table and chart below), that investable hedge fund indices performance is very similar to a universe of hedge funds above USD 20mm accepting new monies and/or hedge funds of funds. Additionally, studies have shown that for example the equity style indices of different index providers have similar heterogeneity of returns like that of hedge fund indices³ (see table “Heterogeneity of Equity Style and Hedge Fund Strategy Indices” below).

Representativeness should be verified by UCITS and can hardly be defined by special additional criteria, since hedge funds should not be disadvantaged especially compared to e.g. commodity and real estate indices.

Correlation Coefficient Apr-2003 to Sep-2006	Notes	ARIX Composite	Credit Suisse - Tremont HFI Investable Hedge Fund	HFRX Global Hedge Fund Index	Credit Suisse - Tremont Hedge Fund Index	HFRI Fund Weighted Composite Index	HFRI Fund of Funds Composite Index	Portfolio all HFs above 20mm
ARIX Composite	investable	1.00	0.86	0.89	0.92	0.88	0.92	0.89
Credit Suisse - Tremont HFI Investable Hedge Fund	investable	0.86	1.00	0.87	0.95	0.88	0.90	0.90
HFRX Global Hedge Fund Index	investable	0.89	0.87	1.00	0.94	0.96	0.94	0.95
Credit Suisse - Tremont Hedge Fund Index	non-investable	0.92	0.95	0.94	1.00	0.94	0.97	0.94
HFRI Fund Weighted Composite Index	non-investable	0.88	0.88	0.96	0.94	1.00	0.95	0.98
HFRI Fund of Funds Composite Index	FoHF index	0.92	0.90	0.94	0.97	0.95	1.00	0.96
Portfolio of all HFs above 20mm	investable universe, has survivorship bias	0.89	0.90	0.95	0.94	0.98	0.96	1.00

³ Cp. Amenc, Goltz (2006): “A reply to the CESR recommendations on the eligibility of hedge fund indices for investments of UCITS”, p. 9.



HETEROGENITY OF EQUITY STYLE AND HEDGE FUND STRATEGY INDICES							
	Equity style indices		Hedge fund strategy indices				
	Growth	Value	Convertible Arbitrage	CTA	Event-Driven	Equity-Market neutral	Long/short equity
Max. return difference	3,0%	7.8%	1.9%	7.2%	2.7%	2.1%	2.9%
Index 1 (return)	4.7%	-3.3%	-1.7%	7.6%	4.0%	2.6%	0.5%
Index 2 (return)	1.8%	-11.1%	-3.7%	0.4%	1.3%	0.4%	3.4%
Index 1 (provider)	Stoxx	FTSE	MSCI	FTSE	HFRX	MSCI	FTSE
Index 2 (provider)	MSCI	S&P	Dow Jones	CSFB/Tremont	FTSE	Dow Jones	CSFB/Tremont
Month of occurrence	Nov 2002	Feb 2001	Apr 2005	Oct 2003	Nov 2004	Jan 2006	Sep 2004

The data used are monthly returns data for the period of January 1999 to December 2005 for the growth and value indices. For the hedge fund strategy indices, we used monthly returns from July 2003 to April 2006 for all strategies except CTA and long/short. For long/short, we used data from January 2003 to April 2006. For CTA, we used data from July 2003 to February 2006. These differences are due to data availability. For example, the monthly data for the S&P CTA index is last available for February 2006 (Source: Hedge Fund Review November 2006).

Q6: Is there a role for any quantitative assessment of the 'breadth' of coverage of the HFI? If so, how would this work?

The representativeness could be verified using the correlation of an investable index with all hedge funds above a certain size and/or all hedge funds available in commercial databases. This could also be done by the UCITS and should not be defined by the regulators.

Q7: Should backfilling be banned for HFIs to qualify as financial indices? If not, why not?

Please explain precisely the grounds underlying your comments.

Backfilling should clearly not be allowed, neither for hedge fund nor for other indices. Investable indices in general do not allow backfilling.

Q8: Should CESR set criteria for the treatment of defunct funds by HFIs for them to qualify as financial indices? If so, what should they be? Please explain precisely the grounds underlying your comments.

Defunct funds should be treated in a way in which they also will be reflected in investors' portfolios. E.g. they should be "frozen" (kept in indices) if their assets are frozen for investors in the funds. The valuation should represent the valuation given by the "liquidator", if available. They should be taken out of the index, if their value is reduced to zero. These rules should not only apply to hedge fund but also to e.g. real estate indices, where similar events could occur with the index underlyings.

Q9: Is disclosure of the index revision methodology sufficient or should controls be placed on the frequency, method or amount of due diligence the index provider must carry out regarding ongoing constituent classification? If so, what should they be? Please explain precisely the grounds underlying your comments.

The index methodology should be transparent, but UCITS cannot be required to verify the details in an ongoing way, since this would also be a disadvantage of hedge fund indices compared to other indices. Maybe CESR can sponsor a continuous review of all and especially new financial indices potentially allowed as underlyings for UCITS by an independent institution, not limited to hedge funds. UCITS fund "sponsors" have a natural incentive to choose only good/attractive indices and may do voluntary reviews of indices.

Q10: Can the UCITS assess the revision methodology of the HFI adequately or should an independent third party be required to review the HFI's methodology? If the latter, how would this work? Please explain precisely the grounds underlying your comments.

See answer to Q 9.

Q11: Is passive versus active selection of constituents the key difference between an HFI and a fund of hedge funds respectively? What could be the other differences? Please explain precisely the grounds underlying your comments.

Most investable hedge fund indices have clear and very stable rules and often have independent committees to select index strategy allocation and components. They are usually characterised by low turnover. Funds of funds have full discretion in strategy and sub strategy allocation and fund selection and no external committees with decisive powers, therefore the differences between the two concepts are very clear.

Q12: Should only HFIs where constituent selection depends solely on publicly available objective rules qualify as financial indices? If not, why not? What sort of subjective judgments could be used to select underlying constituents? Please explain precisely the grounds underlying your comments.

HFI should publish their index rules, but it is not clear how anyone can verify if they are truly objective, especially given the private placement nature of the hedge fund market. Many other financial indices publish their rules but nevertheless replication of the rules by an independent body may lead to similar, but not necessarily identical results. Example: There is no objective rule to differentiate open or closed hedge funds since hedge funds may be open for large institutional investors, given their investment rules, but not for small retail investors. Similarly, index tracking products of popular financial indices always show tracking errors, because even such indices cannot be perfectly hedged, sometimes because of some subjectivity in the index rules.

Q13: Are there any competition aspects CESR should consider in the context of hedge fund indices compared to funds of hedge funds? Please explain precisely the grounds underlying your comments.

We are not aware of any such potential issues.

Q14: Do respondents agree that the ability to verify the value of the index given price data and the HFI methodology satisfies the replicability criterion? If not, why not?

Yes. Index providers are interested in many index-tracking products and will take care that the investable index will be replicable and accounting for the closed fund and limited liquidity issues of hedge funds.

Q15: Should CESR set requirements for verification of NAV calculation and independent custody arrangements/robust governance structures for the underlying constituents of HFIs to qualify as financial indices; or as an alternative, should the UCITS be required to assess the due diligence procedures of the index provider in respect of the underlyings in this regard? Please explain precisely the grounds underlying your comments.

No, since this neither applies to other indices. Sponsors of UCITS should only be required to only allow “quality” investments in their portfolios and therefore only select indices, which are of good quality in their opinion. We do not see CESR judging the quality of the index methodology, but an independent (annual) study could try to do so.

Q16: Should a minimum monthly publication frequency be a requirement for HFIs to qualify as financial indices? If not, why not, and what frequency would be suitable?

Yes, but this should also apply to all financial indices.

Q17: Should CESR require an independent audit of the calculation of HFIs to qualify as financial indices, or should the market be left to decide whether this would be an attractive option for an index provider to put in place? Please explain precisely the grounds underlying your comments.

The market should decide or CESR should require all financial indices to be audited independently. Index constituents should supply audited data to the index sponsor, though, but this should not necessarily be a standard (hedge fund specific) requirement.

Q18: Should it be a requirement for an HFI to qualify as a financial index that its full rules are publicly available (rather than just material rules)? If not, why not?

HFIs should be treated the same as other financial indices. But since index rules cannot be legally protected, the full disclosure of all details should not be required. Index providers and product providers for the indices will have to disclose most of the rules in detail anyhow if they want to generate new business.

Q19: To qualify as financial indices, should HFIs be required to disclose at all times details of their constituents (e.g. list of underlyings, their classification, and the weight applying to them, if appropriate)? Is there other information about the HFI that should be disclosed? Would this be done via the index provider's website? Please explain precisely the grounds underlying your comments.

HFIs will have to disclose most of the constituents in detail anyhow (at least to the interested UCITS) if they want to increase their business. There are two reasons not to disclose constituent details publicly, though. 1) Most hedge funds have to adhere to private placement rules. Hedge funds may be accused of violating them, if details about them, especially their performance, are publicly disclosed. 2) Many good hedge funds have limited investment capacities. As discussed, index providers need to make sure that hedge funds in the indices pass certain quality criteria. Also: Good single hedge performance may become public as an

index constituent. This may induce investors to invest in such hedge funds, potentially limiting their due diligence efforts, based on the fact that the index provider has approved such funds. Capacity of these funds may therefore shrink quickly, which may lead to increased index turnover and potentially higher cost for index sponsors. The funds themselves will get bigger, have poorer performance, and become closed and thus not investable anymore. Moreover, according to our knowledge, index providers like MSCI also do not publish the constituents of their equity indices.

Q20: Should a UCITS which intends to invest in derivatives based on HFIs have to disclose this fact in its prospectus or other documents? What degree of information should a UCITS which intends to invest in derivatives based on HFIs have to disclose in its prospectus? Please explain precisely the grounds underlying your comments.

Disclosure of investment in hedge fund underlyings in UCITS can be required, but then UCITS also should disclose investment in other financial indices. In general, UCITS sponsors should decide what to disclose in addition to their minimum disclosure requirements. If they want to sell the ability to invest in hedge funds, they will have to disclose it anyhow.

Q21: Do you have any other comments relating to hedge fund indices that CESR should consider? What are they?

No.

Q22: From the regulatory and retail investors' point of views, how do you assess the situation of competition between funds investing in derivatives based on HFIs and funds of hedge funds? Please explain precisely the grounds underlying your comments.

UCITS would benefit from hedge fund indices by finally being able to refer to an absolute return benchmark other than "Cash". In any case, the competition between "absolute return" UCITS and hedge funds of funds has started and should be welcome by regulators worldwide. The possibility of UCITS to invest in hedge fund index-linked derivatives would further increase the appeal and competitiveness of regulated UCITS versus unregulated hedge funds of funds and is therefore very positive. This could be the smartest (regulatory) way to force "bad" hedge funds of funds out of the market. Hedge funds as an aggregated segment have shown very few and little losses and other risks like volatility over extended periods of time while consistently producing positive yearly annual returns and very low correlation to bonds and moderate correlation to equities. Allowing UCITS to have access to hedge fund index derivatives makes them certainly more attractive to investors and will enhance competitiveness of regulated UCITS also in comparison to mostly unregulated structured products. The result will be that UCITS will

have the ability to access more asset classes and thus increase their diversification potential and reduce risk. An example can be the asset allocation of the Yale university endowment. A weight restriction of the exposure of UCITS to hedge fund indices is of course worth considering.

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