

## **Philipp M Hildebrand: Financial Stability and Hedge Funds: Effective and Ineffective Supervision**

Speech by Mr Philipp M Hildebrand, Member of the Governing Board of the Swiss National Bank, Diskussionsforum «Nachbarn Deutschland-Schweiz: Impulse für die Zukunft», Berlin, 9 November 2005.

*The complete speech can be found in German on the Swiss National Bank's website ([www.snb.ch](http://www.snb.ch)).*

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The hedge fund industry has grown rapidly over the past few years and it has become an important segment of global financial markets. The possibility to use leverage and a high degree of flexibility are key elements of a broad range of investment strategies which have made the hedge funds industry very profitable. Hedge funds have been an important source of innovation in the traditional asset management industry and they have rendered financial markets more liquid, more efficient and more flexible. Nonetheless, the rapid growth of the industry and the excessive use of leverage may result in potential systemic risks which are relevant to central banks, unlike prudential matters. Overall, industry leverage is difficult to measure. However, several studies suggest that it is lower than at the time of the near collapse of LTCM in 1998. Even so, temporary excessive levels of leverage with single hedge funds can not be ruled out completely. A crisis in the hedge fund industry might therefore spill over to their primary trading partners, the major investment banks. Hence, regulation and supervision in order to minimize systemic risk should concentrate on the leading global investment banks to make sure that adequate counterparty and liquidity risk management systems and processes are implemented. Against the backdrop of scarce resources, we should refrain from opening new regulatory fields which are not relevant for systemic risks.