

The Role of Hedge Funds in fostering Regulatory Innovations-A Systematic Literature Review

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Abstract

The purpose of this paper is to evaluate the relationship between regulatory magnitude and hedge fund market stability, transparency, and general performance across jurisdictions. The methodology used is a systematic literature review using keywords like “hedge fund regulation” and “systematic risk” with only papers from 2018-2024 and from specific Meta databases. The literature review discusses how the presence of robust regulatory oversight reduces the likelihood of systemic risks associated with hedge fund activities. This is coupled with how stricter regulatory frameworks lead to improved transparency and how increased reporting requirements for hedge funds can positively impact market stability. Major findings include successful regulatory efficacy with acts like the Dodd-Frank Act, mixed market impacts, and significant innovation trade-offs. This paper involves a comparison between legislation affecting hedge funds in America and hedge funds in India alongside the impact it has on their performance and results. This paper also involves case studies of hedge funds contributing to legislation directly and indirectly through mechanisms of influence like lobbying and self-regulation. The implications for policymakers are notable, as they must balance transparency mandates with proportionality to avoid stifling smaller funds. Additionally, a major trade-off that regulators must solve is between investor protection and hedge fund growth and performance, as previous regulation has shown consistent increases in compliance costs. To end with, the paper also includes policy recommendations like increased reporting requirements and global coordination in order to combat the existing problems in the hedge fund industry with evaluation and consideration of phenomena like regulatory capture.

Keywords — Hedge funds, Regulatory innovation, Legal framework, Systemic risks, Dodd Frank Act

I. INTRODUCTION

In the Past Few Decades, Global Financial markets have gone through a magnetic transformation driven by technological advancements, the introduction of rigorous regulatory frameworks, and the growing complexity of financial, trading, and macroeconomic instruments that dictate, govern, and influence investment trends and the decisions of Asset Management Companies and Governments on a large scale. World's top financial centres are growing more competitive along with drastic increases in the share price index of major developed and emerging economies (**Adopted from statistia report, 2023**) with new emerging economies going through revolutionary periods of financial market growth compared to older, well-established ones.

These Growing financial markets have also created a need for functional, investment and securities regulation to protect investors and other key stakeholders in the constantly evolving financial landscape. In this Drastic Revolution, Hedge Funds have played a pivotal role in enhancing market efficiency and in effecting asset valuations and stock price. For setting the scope of this paper, Hedge funds are actively managed investment pools whose managers use a wide range of trading strategies in an effort to beat average investment returns for their clients. Hedge Fund's flexible and vast categories of investment strategies, ability to operate with a vast range of security classes alongside a specialized risk exposure has helped translate into a unique perspective on the economic health of stock markets. The most classical and oldest hedge fund strategy has been to “hedge” assets against each other for better returns which is from where they get their name. Although a lot of hedge funds don't actually use “hedging” as a part of their strategy it has proven effective in the sense of how hedge funds absorb the fewest shocks from equities, commodities and bonds (**Papathanasiou, etl. 2022**). Despite their flexible strategies and approach there are certain key drivers of hedge fund growth that differ during “bad economic times” and “good economic times” (**Stafylas, D etl. 2020**), which can be seen as a drawback to ultimate hedge fund growth. Fig 1 shows the incredible growth of Hedge Funds denoted by a growing AUM (assets under management) which shows that every single year they control more of the global economy.

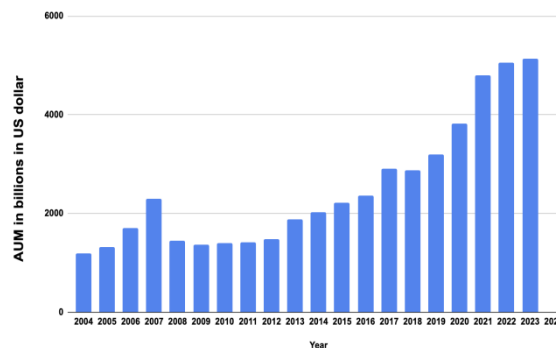


Fig 1.AUM of Hedge Funds, growing every year reaching just over 6 trillion dollars.

While the power they wield to influence global markets exponentially increases each year with the introduction of their groundbreaking financial products and strategies, simultaneously Hedge Funds have also created a potential for new systemic risks and challenges that traditional securities regulatory frameworks and other market safety are ill-equipped to address. In the past few years, it can be argued that hedge funds have had scope to serve as systemic dangers to financial landscapes and threats with characteristics like absolute size, excessive leverage, liquidity shocks and the Herding Behaviour states in **(King, M. R., etl 2009)** which they tend to induce in financial markets in times of economic Booms or Busts. This has raised questions about the adequacy of existing regulatory systems in managing the complexities brought about by these risqué market innovators. For the scope of the paper, Regulatory Innovation can be defined as the creation and implementation of regulations and legal frameworks aimed at addressing emerging challenges and pionering current systems such as Hedge Funds and the systematic risks they pose.

Hedge Funds create horizons for new regulatory frameworks in multiple ways. Firstly, hedge funds pioneer new financial products, such as complex derivatives in the form of futures and options or structured products like currencies and stocks often shifting from the safer investment products like traditional treasury bonds or real estate. The Development of these hedge funds challenges the conventional investor wisdom about risk, reward and even the leverage hedge funds might decide to take in their investments. Alternatively, another way in which they influence and contribute to regulatory changes is through their affluence, impact and significance in financial markets. Additionally, there has been a consequent rise in Hedge Fund Activism outlined by the paper **(Fiorillo, P., etl 2024)**, where hedge funds acquire minority stake in companies and use that to push changes that would eventually increase shareholder value. This strategy of Hedge Fund activism has also been said to reshape corporate innovation by increasing innovation efficiency over the five-year period following hedge fund intervention **(Brav etl 2018)** This is further evidence as to how their grasp on the financial market is constantly expanding as they continue to use new complex strategies like activism and influencing corporate innovation which has been proven beneficial to grow.

The rise of hedge fund's global influence has prompted regulators to reconsider existing financial oversight mechanisms. In several recent cases, the rapid growth, complexity and controversial decisions of hedge funds have directly influenced the development of new regulations and have managed to create a huge future scope for the deployment of further regulations. Insider Trading Cases with Hedge funds such as SAC Capital in 2014, Galleon Group in 2009 and Pequot Capital in 2010 have helped shape considerable protections and shields against Insider Trading that protect investors and markets at large. The less popular case of LTCM in 1998, which almost destroyed the financial system serves to be a torchbearer which showed the risks of hedge funds using highly leveraged strategies. Another Barrier that arises in the case of hedge fund regulation is how increasingly more hedge funds are staying private and not going public since listed firms tend to severely outperform unlisted, private asset management firms and hedge funds as stated in **(Sun, L. etl 2019)**.

This paper aims to navigate the role of hedge funds in fostering regulatory innovation, examining how their activities challenge existing regulations and necessitate the development of new regulatory responses and frameworks that can effectively address their unique characteristics and risks which pose a risk to delicate and easily influenced global markets which hedge funds might exploit for their benefit alongside a comparison between the legal landscapes of two different economies that help us assess their effectiveness across different environments which is a huge factor that plays role in Hedge fund strategies addressed by **(Almeida, C. etl)**. This paper also aims to compare different jurisdictions and how hedge funds operate in them, similar to **(Bianchi, R etl)**.

This paper is structured as follows: Section II gives the literature review, the paper focuses on how regulation can reduce the likelihood of systemic risk, promote transparency and positively impact market stability by an increase in reporting requirements with a comparison of the regulatory landscape of hedge funds in USA and India. Section III includes the Research Methodology which focuses on recent case studies about how hedge funds foster regulatory innovation through direct methods and mechanisms of influence like Lobbying. Section IV includes the Discussion of the paper alongside its purpose, limitations and potential future research. Section V shows the Findings of this paper alongside Policy Recommendations that could be implemented in order to solve existing problems of the Hedge Fund industry.

II. LITERATURE REVIEW

A. The presence of robust regulatory oversight reduces the likelihood of systemic risks associated with hedge fund activities

As mentioned before Hedge Funds are actively managed investment pools which hold liquid assets and make use of trading and risk management techniques which are controlled by the Hedge Fund managers, which tend to play a key role in the funds performance. Hedge Fund managers make decisions on behalf of the clients who contribute to the large investment pools. Hedge Funds are extremely complicated and tend to be ambiguous because of their unique strategies, multiple factors and drivers that affect their success alongside the lack of transparency and regulation which is what the paper is essentially centred around. The name itself which is “Hedge Fund” describes the single main strategy that these types of funds were using which is “Hedging” assets against each other in order to ensure that you have taken positions so that if one asset declines, the other gains which is now more commonly called a “Long Short”.. If a hedge fund wanted to invest 60% of capital in long positions and 50% in short, then the gross exposure for the hedge fund would be 110% and the hedging leverage would be 10%. Hedging Strategies that aim to mitigate risks while securing returns in financial markets have become incredibly popular and essential in recent times with increasing global volatility that open up huge scopes for systemic risks like the global financial crisis during which hedging strategies were more prone to cushion large scale portfolios and investors against market disruption (Judijanto, etl. 2024). A Huge decider of Hedge Fund strategies and ultimately their performance are hedge fund managers which tend to perform better if they have factor timing skills. According to (Osinga, etl. 2021) top factor timing ability funds which time factors like the market, size and other bond factors outperform the bottom factor timing funds with a 42.3 per annum. Popular Hedge Fund strategies include Event Driven, Equity Hedge, Macro, and Relative Value arbitrage with only the macro strategy having market timing ability mentioned before (Noori, M. etl. 2023) In the same paper it is discussed that Hedge Funds are focusing more on futures contracts than equities as the exposure to equities across Hedge fund strategies has reduced since the great financial crisis. This raises regulatory concerns of Hedge Funds especially under different crises, like the GFC and Covid 19 where funds increased their exposure to commodity futures.

Due to their volatile strategies, involvement with private credit and the Great Financial Crisis and the propagation of systemic risks that came alongside it, Hedge Funds have become a topic of regulatory discussion. In the Global Financial Crisis it was discovered that systemic risk is not confined to bank entities as non bank financial firms like Hedge Funds can also propagate financial risks leading to a need for regulation (Kress. etl. 2018). The GFC originated from the US market and eventually spread out in the form of strings of systemic risk across other financial markets. This led to the US implementing reforms and regulatory changes that impact Hedge Funds, with the main bill being the Dodd Frank Act of 2010. The Dodd Frank Act, launched in response to the GFC, includes multiple mechanisms that can stop the spreading of systematic risk across markets. One such mechanism is the Systemically Important Financial Institution or SIFI designation that the oversight council designates to certain institutions who are considered “systematically important” or “too big to fail”. This helps regulatory councils monitor and regulate hedge funds with better efficiency which results in the reduction of systematic risk associated with hedge fund activities (Kress. etl. 2018).

B. Stricter regulatory frameworks lead to improved transparency and reduced risk-taking behavior among hedge funds.

The Dodd Frank Act (Adapted from Dodd Frank Act, 2010) requires Hedge Funds and other non bank entities to register with the SEC alongside increased reporting requirements for Hedge Funds that manage over 150 million dollars. Additionally the Volcker Rule which is a part of Dodd Frank restricts banks from engaging in trading and limits their investments in hedge funds. Finally, this act aimed to target a major characteristic of Hedge Funds that served as scope for systemic risks which is leverage. Hedge Funds using High leverage faced increased scrutiny under the act as it mandates that hedge funds disclose their leverage ratios to regulators. It has been 15 years since the Act was passed and studies like (Cumming, D etl. 2020) argue and show that after the implementation

of the Act, Hedge Funds have experienced greater fund outflows or lesser fund inflows which translates to higher costs and lower profits because of the multiple terms and conditions of the act that place a huge whole in the profits of Hedge Funds alongside a loss in the percentage of Hedge Funds domiciled in the US, with a drop from 15.2% to 14.58%. Additionally, the study also shows that after the implementation of the Dodd Frank Act most US Hedge Funds had lower alpha compared to non US funds as the pre dodd frank alpha value of US Hedge Funds was 0.35% and post dodd frank was 0.19%. The alpha value of a fund is a term used in investing to describe an investment strategy's ability to beat the market which means that after the act funds were less likely to beat the market. This shows that whenever financial regulation is implemented in the US, especially concerning hedge funds, there is an increase in compliance costs which impacts the fund negatively. Even Though, this study does offer a comprehensive view with data, other studies offer a slightly different view. (Restrepo, F. 2024) argues in a similar manner in the terms of how after the act there was a significant decline in investor profitability, and that compliance costs decreased with a profit reduction of 4.5%. However, the paper offers a truly evaluative view addressing how even though there were several rules levied on leverage risk taking did not change significantly and capital formation in the form of AUM did not decrease which can be shown by the year on year increase in the AUM of US hedge Funds. The paper also addresses that the direct cost of compliance is only between 0.1% and 1% of AUM per year. It is also important to note that the stricter regulatory framework has led to lower risk taking behaviour among hedge funds as many specifics of the Dodd Frank act like the Volcker Rule are crucial as they restrict banks from engaging in proprietary trading and from owning hedge funds and private equity funds. By the limiting of these activities, regulators aim to reduce the popularises risk taking behaviour among funds(Restrepo, F. 2024).

The Dodd Frank Act and the overall regulatory landscape can be compared to the regulatory landscape of India to compare and identify how hedge funds are regulated across different financial markets. (Mahato, M. etl . D. 2020) provided a brief overview of hedge fund legislation in India which includes the SEBI Regulations 1995, and the SEBI (Alternative Investment Funds) Regulations Act, 2012. Until 2012 AIF regulation there was no significant or specific regulation on governing onshore hedge funds. Hedge Funds are registered as Category III AIF's (Alternative Investment Funds) who employ complex or diverse trading strategies. . The paper also addresses how Hedge fund regulation in India is weaker compared to Hedge Fund Regulation in the USA, where Dodd Frank serves as a stronghold for keeping hedge funds in line.

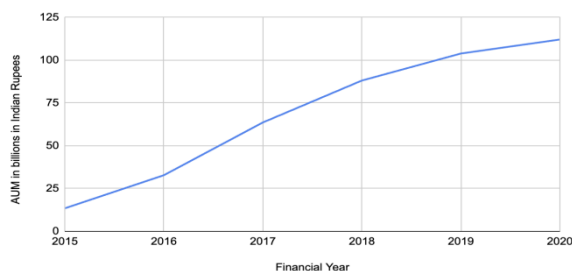


Fig 2: Hedge fund value as a part of individual wealth in alternate assets across India from financial year 2015 to 2020”

(<https://www.statista.com/statistics/725745/india-hedge-fund-value-in-individual-alternate-assets/>)

This weak regulation can be seen through Figure 2 which both show the increase in growth and progress of Indian hedge funds, through hedge fund value as a part of individual wealth in alternate assets across India from financial year 2015 to 2020. Weaker Regulation allows hedge funds to operate easily with lower barriers and limitations that results in higher profits and a Higher AUM value at the end of each financial year leading to overall growth in the whole industry. However it is important to note that this growth could be unsustainable in the long run and could be coming along with reduced transparency and increased risks for investors. Figure 3 below provides a more comparative analysis between the hedge funds india as opposed to funds in asia and emerging countries, which provides an insight into the humongous and accelerated growth of the returns of Hedge Funds that operate in india.

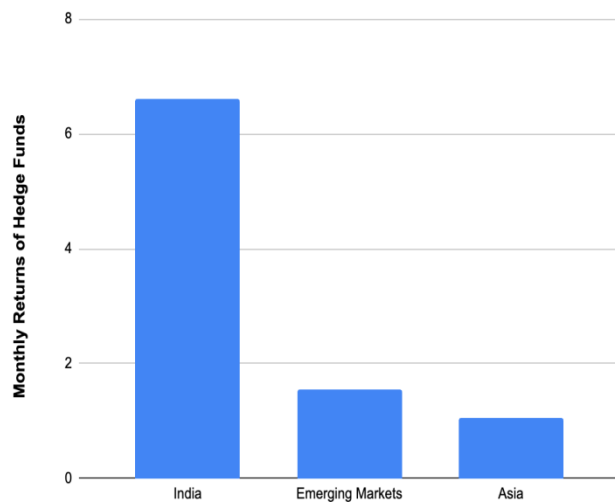


Fig 3: Adapted from the Business standard's 2021 Report of Indian Hedge Funds: https://www.business-standard.com/article/markets/indian-hedge-funds-beat-asian-em-peers-provide-6-6-returns-in-may-121063000045_1.html#goog_rewarded

C. Regulatory changes that increase reporting requirements for hedge funds positively impact market stability by improving information flow.

Moreover, (Duygun, M., et al., 2020) argues that Regulatory changes that increase reporting requirements for hedge funds positively impact market stability by improving information flow as the paper raises concerns about monitoring market participations to ensure a globally financial stable environment as highlighted by the GFC that companies other than banks- like hedge funds can also have a impact on the whole economy. In June 2009 the DFA also included registration requirements and higher disclosure of proprietary information for hedge funds which has created a more financially stable environment as the activities and the results of hedge funds are not only made public but also available to regulatory agencies like the SEC which means that their ability to cause and propagate systemic risk and negatively impact the market stability is strictly controlled.

With the recent transformation of technology and the introduction of AI, it is also important to assess how hedge funds are making use of artificial intelligence and new technology. Artificial intelligence which is a key technology developed in the 2010's has become increasingly resourceful and common in the world of finance with papers like (Ahmed, S. et al., 2022) analyzing and reporting the upward trajectory in publications on AI in finance since 2015. The Paper also addresses how artificial intelligence is used in 6 different streams of finance with categories like credit risk assessment, stock price prediction, portfolio management, price prediction of oil, gold and agricultural products alongside big data analytics being relevant for hedge funds. Many Hedge Funds around the world like the American Hedge Fund Citadel have automated their trading process with the use of AI and advanced data sets that execute trades for them. With technology like AI becoming advanced and expanding each year, new components and elements like Robo Advisors have also been introduced that can serve as a game changer for hedge fund performance. Robo advisors are defined as mechanised platforms that use automated algorithms to provide financial advice to investors. Papers like (Tao, R et al., 2021) argue and report that Robo advisors which have been a key piece of innovation resulted out of the 4th industrial revolution democrats superior performance compared to older and more traditional methods like equity, fixed income, money market and hybrid funds. Other studies like (Shanmuganathan, M., 2020) offer a more evaluative approach alongside a longitudinal case study of how robo advisors continue to impact and disrupt the financial world through methods like robo advisors integrating further financial technology or (Fintech) into portfolio management. Additionally it is also important to note that this "4th Industrial Revolution" brings along other inventions and discoveries like green bonds and cryptocurrencies that have changed portfolio management for big investment titans like hedge funds. Papers like (Sangwan, V. et al., 2020) Show that not only does artificial

intelligence play a role in finance with components like Crowdfunding, P2P lending and shadow banking but also has future prospects in the regulatory world. Elements like RegTech, Regulatory Sandboxes and TechFin can be used to regulate entities of financial markets like hedge funds.

It is important to note that ever since the GFC there has been increasing demand for transparency from clients and regulators on hedge funds all over the world. Due to their growing influence and ability to impact companies through changes in corporate governance and hedge fund activism it is important to tightly regulate them and add extra layers of oversight to ensure minimal spread of systemic risk in a next potential financial crisis. Even though acts like Dodd Frank have been implemented, hedge funds are still able to operate in secrecy especially when they manage less than 150 million dollars which means that they don't have to be registered with the SEC. This leads us to question and evaluate How can hedge funds be even more regulated alongside how they can and already regulate themselves leading to all parties involved being satisfied.

TABLE I

Reference	Key finding	Research Gap	Limitation of the paper
15	Regulation led to lower fund alpha	Regulation also led to increased Compliance Cost	hedge fund activism and relation with size
13	nonbank financial firms can propagate systemic risk throughout the financial system	2 strategies that could be used to combat systemic risk	research into entity based regulation like hedge funds
5	considering the HFA as a new governance mechanism capable of unlocking the targeted companies value	summarize the extensive knowledge acquired over time	This paper focuses primarily on the US market.
10	traditional themes such as financial markets, commerce, and investment remain central to the literature	strong collaborative networks between countries and institutions, with the United States, China, and the United Kingdom	How traditional hedging techniques can be adapted to new asset class
17	Compared to other countries Hedge Fund Regulation in India is weaker	Regulation in prominent financial markets is stronger	comparing how well regulation in different areas of the world resolves the trade off of compliance costs
7	Performance varies between funds because of fund exposure to higher order moments of the benchmark factors	more hedge funds are staying private and not going public	looking towards the impact of hedge fund strategy
12	There are strong shock spillovers from hedge fund industry to other financial markets	risk-reward measures show that hedge funds are superior to other markets	impacts of hedge fund strategies on financial assets and regulation
23	negative association of corporate lobbying on firm performance	firms with high growth opportunities benefit more from lobbying than low-growth firms.	Wider effects of Lobbying

III. RESEARCH METHODOLOGY

The primary objective of this research is to analyze how strong regulatory frameworks can enhance the operational integrity and transparency of hedge funds, resulting in the mitigation of systemic risks and protection of investors. This study aims to identify specific regulatory measures that can effectively address the unique challenges posed by hedge funds, while also evaluating the implications of these regulations on market stability and investor protection by asking three major questions:

RQ1. What are the main elements of current regulatory frameworks governing hedge funds in prominent financial markets?

RQ2. How do existing regulations safeguard investors from the potential risks linked to hedge funds?

RQ3. What systemic risks do hedge funds present, and how can regulatory frameworks be enhanced to mitigate these risks?

The methodology employed to achieve these objectives to answer this question is Qualitative research that was done by performing content analysis of existing hedge fund regulation, focusing on case studies that not only illustrate successful regulatory frameworks but also instances where hedge funds have directly caused regulatory innovation through lobbying. This Methodology involves the use of Secondary Data from Meta databases like Scopus, WoS, ABDC journals and financial reports from hedge funds, data from financial databases like Statistia, Mckinsey, Deloitte and Business standard alongside government websites.

The Role of Hedge Funds in fostering Regulatory innovation is quite a contested issue as there are multiple ways in which Hedge Funds can lead to more regulation that directly impacts them alongside maintaining the trade off between upholding the interests of consumers and governments and keeping compliance costs in check. One way that hedge funds can foster regulatory innovation is through directly leading to legislation that governs them and is successful which can be seen through the following case studies:

a. The Children's Investment Fund Management (TCI): TCI is authorized and regulated by the UK's Financial conduct Authority (FCA) which shows how regulatory oversight can align hedge fund strategies with ethical standards.

Impact: This example of TCI adhering to regulation demonstrates how FCA's oversight ensures that it adheres to principles of promoting market integrity and protecting investors. This also includes how TCI follows and aligns with compliance guidelines on Environmental, Social and Governance factors which are becoming increasingly crucial in sustainable and investment strategies. This relates to how close oversight of Hedge funds by regulatory entities is not only crucial in the regulation of non bank entities but also to ensure that they don't propagate systemic risk in times of financial crisis as explained by (Kress. etl . 2018).

b. Renaissance Technologies' Compliance measures: Widely known for its quantitative trading strategies, Renaissance Technologies operates within a robust regulatory environment that shapes its compliance culture as the firm's adherence to regulation like the Dodd Frank Act and Investment Company Act of 1940 has contributed to its sustained success and valuable reputation.

Impact: This particular example of Renaissance Technologies goes against the popular belief that regulation often increases compliance costs for Hedge funds and leads to inefficiency. This example aligns with (Restrepo, F. 2024) which does not focus on the increase in compliance cost but the increase in the ability of capital formation alongside third party benefits for investors and regulators through increased reporting requirements.

c. Citadel LLC's Risk Management: Citadel's renowned risk management system which includes daily stress tests and scenario analysis, operates within the parameters set by financial regulators. This precision and dedication to the regulation ensures that Citadel maintains market stability and investor protection, exemplifying effective regulatory influence.

Impact: Citadel's compliance with regulatory agencies serves as an example of how hedge funds can still grow consistently and expand while following regulation which benefits markets, consumers and hedge funds themselves. This is supported by (Duygun, M.,etl, 2020) which demonstrates how increased regulation such as increased reporting requirements has a positive impact on investor protection, confidence and market stability which is not only advantageous for investors but also funds like Citadel.

One of the other ways through which hedge funds can foster regulatory innovation is through Mechanisms of Influence that Hedge Funds can employ like Lobbying alongside the additional components such as self regulation and the development of financial products.

A) Lobbying

Lobbying in the context of Hedge Fund regulation can be defined as the efforts by businesses, industry groups, or other stakeholders to influence government policymakers or regulators in a way that benefits their interests. Lobbying can be a great legal tool for hedge funds in the sense that it is instrumental in reducing regulatory burdens and influencing rulemaking at the same time. Corporate Lobbying also provides dynamic innovative benefits for the hedge funds themselves. Additionally, other benefits include how lobbying can be used to Avoid New Regulation that could increase compliance costs which directly impacts the balance sheets of Hedge Funds. Moreover, Lobbying can also be used to improve the overall financial and regulatory environment which would not only benefit players in the firm but the positive benefits would also pass down the supply chain. Papers like (Jiao, A., etl 2024.) argue that lobbying positively influences firm innovation outcomes and that it enhances the firm's external political environment. The study explores and links how politics has become extremely relevant in finance through tools like lobbying and regulation influencing. Below are some examples of Hedge Funds that have engaged in Lobbying alongside the impact that they yielded.

a. MFA and Dodd Frank: The MFA or the Managed Fund Association representing hedge funds, had doubled there spending on lobbying in 2010, which was strictly focused on altering policies like the proposed Consumer Financial protection Agency and the incredibly vague and ambiguous jurisdiction of the Commodity Futures Trading Commission over Derivatives

Impact: The MFA successfully pushed for exemptions and modifications to certain provisions of the Dodd Frank Act for decreasing the amount of information that hedge funds have to disclose in order to protect hedge fund strategies. The MFA also succeeded in lobbying for more flexible interpretations of the Volcker Rule of the Dodd Frank Act for activities like market making

and the classic hedge fund strategy of hedging discussed previously. This links to how (Jiao, A. etl 2024) argues that lobbying can enhance a firm's innovation outcomes and external political environment.

b. Renaissance and the 2 parties: During the 2016 election cycle, Renaissance Technologies was the top hedge fund contributing to federal campaigns with donations surpassing 33.1 million by July.

Impact: The impact of this strategy of lobbying has been extremely limited with the direct effect of these actions not being well documented in public sources. This links to the results of (Cao, Z. etl 2018) which takes a double sided approach while discussing the impacts of lobbying but states that firms with greater growth opportunities can benefit from Lobbying which is accurate for the case of Renaissance Technologies as that fund is known for there revolutionary quantitative algorithm that is robust and brings along increase opportunities for progress .

c. MFA and the Transparency Rules Delay request: In January 2025, the MFA requested the SEC to delay enforcement of transparency rules requiring detailed disclosure about the specifics of hedge funds to protect the economic benefits that they can enjoy such as job creation, liquidity provision and market efficiency.

Impact: MFA has managed to maintain a more favorable public narrative for hedge funds even in recent times which reflects how the powerful and established lobbying entities like the MFA can truly gain from this practice. The power of lobbying entities demonstrated is supported by (Jiao, A., etl 2024) as it extrapolates the idea of how the benefits of lobbying are accelerated if the firms have comparative advantages in the market such as financial health and institutional support. This is accurate for hedge funds in general and all the members of the MFA.

Through these 3 case studies we can see how Lobbying can be used to protect and maintain hedge fund interests. However there is some opposition to this practice. Many policy makers believe that hedge fund and other investment titans might benefit from too much regulatory leniency, particularly regarding transparency and leveraging with risk. Moreover studies like (Cao, Z. etl 2018) argue that for the average firm lobbying has a negative impact on firm performance and that even more complicated firms like Hedge Funds experience a stronger negative correlation with lobbying. It is also important to note as a part of this evaluation that the study also addresses how firms can offset this negative correlation with higher growth opportunities which lead to firms benefiting from lobbying.

B) Self-Regulation

Self-Regulation in the context of Hedge Funds and Finance can be defined as the practices that hedge funds implement internally to ensure they comply with legal, ethical, operational standards, even in the absence of direct regulatory oversight. Different Methods of Self-regulation include compliance programs, Risk Management, Internal Audits and the code of Ethics that sets guidelines for the behavior of employees and fund managers. It has to be noted that these methods are more for the purpose of maintaining a reputation for reliability and integrity as opposed to affecting the quantity and quality of control they have over financial markets and political and legal landscapes. (Honigsberg, C. 2019) shows that increased regulation from policymakers can actually lead and further incentivise firms to make changes in their internal governance and self regulate.

C) Evaluation of these Methods and Policy Makers through a Regulatory Capture

It has to be noted that the main legislation that affects hedge funds is drafted by policymakers and legislators who maybe influenced through the level of self regulation of hedge funds or the Lobbying carried out by them. When we study how policy makers and regulators draft legislation to regulate and place limits on Hedge Funds it is important to discuss deciding parameters and factors that affect the legislation produced like the Self Capture Theory.

A Regulatory Capture in behavioural and legal economics dictates that the regulation of a certain industry is affected in order to meet the requirements for regulation of industry which translates to how that legislators are almost "captured" the industry when investigating and that the regulatory organization is indirectly controlled and influence by the Biggest players of the Industry. This might be done in the sense that Hedge funds might exert significant and excessive influence over regulatory agencies through lobbying and political donations, leading to a regulatory capture. (Saltelli, A.2022) examines 5 case studies of Regulatory Captures in Europe which show how excess lobbying can create a worldview where the very idea of regulation becomes undesirable. This Dilution of oversight could not only encourage risky trading practices but also the privatization of legislation in the Hedge Fund industry which serves as a multiplier for systemic risk across financial markets that would disrupt the financial supply chain.

Theoretical Framework:

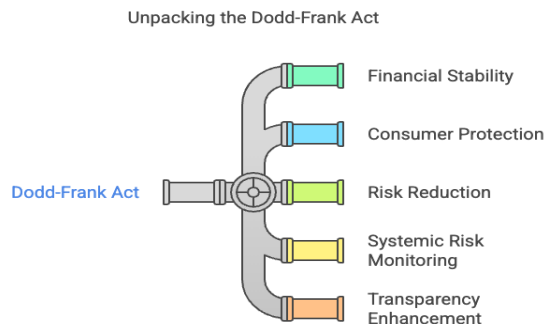


Fig 4: Self made adaptation showing the key features of the Dodd Frank Act- the landmark financial and Hedge Fund regulation in the United States of America

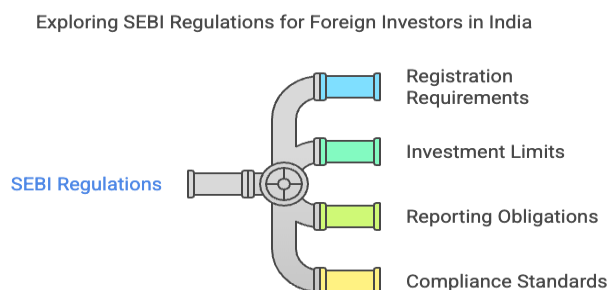


Fig 5: Self made adaptation showing the key features of the SEBI Regulations Act- the landmark financial and Hedge Fund regulation in India.

IV. DISCUSSION

The Hedge Fund regulatory framework alongside the legal powers of Lobbying used by firms has dramatically evolved post 2008 with major legislative changes like Dodd Frank driving transparency for consumers while speaking debates and arguably worsening compliance costs for firms. There are interesting studies regarding the topics discussed in the paper. Papers like (**Filatova, H. P. etl 2023**). The findings of this study show that before 2000 studies focused on the legislative aspect of combating financial fraud as the GFC in 2008 re-routed the attitudes of scholars and policymakers towards risk management and the impact of financial fraud on economic growth. There are 2 other papers which study Dodd Frank and its impact in great detail and have been mentioned in this paper. (**Cumming, D etl. 2020**) takes up a one sided view where it argues that the Dodd Frank Act has actually increased compliance costs, lowered alphas and created inconvenient situations in which fund inflow is less than fund outflow. This is different from (**Restrepo, F. 2024**) which takes a more evaluative and double sided view and argues that hedge funds did face a significant decline in investor probability and that compliance cost did increase but the increases did not change the ability of hedge funds to amass more profits and increase their AUM every single year possible denoting positive effects.

The Purpose of this paper is focused on addressing main questions around the intensity and quality of Hedge Fund Regulation, not just in the USA but in India as well which is an aspect that is ignored by most mainstream studies around this topic. Moreover, this paper discusses both- the traditional way that hedge funds are regulated and self regulation with case studies that dive into instances where Hedge Funds lobby for their interests and carry out self regulation. This paper dives deep into how hedge funds can cause and propagate systemic risk alongside discussing and evaluating mechanisms like the Dodd frank act to prevent hedge funds taking up excess leverage and propagating systemic risk.

Additionally, The paper dissects Hedge Fund legislation, its impact and purpose with the Context of the GFC alongside a cross regional analysis, using regulation in America in comparison with Regulation in India. Moreover, this paper also includes relevant

case studies and addresses how hedge funds can contribute to fostering regulatory frameworks, whether that be through bills or whether that be through Lobbying and Self Regulation which has been analysed in this paper.

However this paper is not void from limitations. The limitations of the paper include that it only uses data from secondary databases and other already existing papers with no new primary data collected. Moreover, This study fails to acknowledge the impact of Hedge Funds and their regulation across continents and only focuses on the two major countries of the USA and India neglecting other growing economies like China and Brazil. Additionally there are also time-frame constraints as the Long term impacts of post 2020 regulation remain untested.

Future scope for this topic of Research includes Technology integration and looking at the strategic and robust role of Blockchain and Artificial intelligence in this industry. Moreover, studies that focus more on Investor Protection Metrics and how Hedge Fund Activism is controlled and regulated by existing regulation could be a useful addition to the existing literature in the field.

V. FINDINGS

The Findings show that Hedge Funds are separate non bank entities that are primarily regulated through national laws that differ vastly from mutual funds that operate differently and are subject to more stringent regulation. Additionally, Hedge Funds operate under exemptions and exceptions that allow them to avoid many registration and reporting obligations just because they cater to accredited investors. In the recent decades there has been a change to this culture in the hedge fund industry as the Dodd Frank Wall Street Reform Act of 2010 mandates registration for hedge fund managers with over 150 million USD in assets. Similarly the European Alternative Investment Fund Managers Directive(AIFMD) imposes similar requirements in Europe. However it is important to note that these requirements have been partially bypassed through Lobbying of which the case studies have been discussed.

Before we start discussing policy recommendations that are relevant to the current financial landscape for hedge funds it is important to discuss the types of regulations impacting Hedge funds. Investor Protection Regulations aim to protect investors by ensuring adequate information disclosure aim to protect investors by ensuring adequate disclosure of information and limiting entry to well-informed investors with the capacity to understand the risk involved. Examples include Securities Act of 1933(Rule 506b and 506c), Dodd Frank Wall Street Reform and Consumer Protection Act of 2010 and Anti-Fraud Provisions(Rule 10b-5 under Securities Exchange Act of 1934). The Second type of regulation is Market Integrity laws that are designed to maintain market integrity by inhibiting manipulation and facilitating effective price discovery. These include capital requirements and exposure caps to contain systemic risks arising from large hedge funds. Examples involve Regulation SHO of 2005 and Regulation Fair Disclosure or Reg FD. The third type includes Systemic Risk Management as the potential for hedge funds to contribute to systemic risk has spurred calls for more stringent regulation. Regulators like IOSCO call for international registration and independent risk management functions for hedge fund managers. Examples include Title IV and the Volcker Rule of the Dodd Frank Act.

Policy Recommendations to solve the existing problems of Hedge funds include Enhanced Reporting Requirements that are Lobbying proof and cannot be removed or ignored just because hedge funds lobby for it. Increasing the frequency of reporting requirements can provide regulators with better insights into hedge fund activities and to make this policy lobbying-proof, the legislation should be anchored in systemic risk and not investor fairness. Moreover it should be enshrined in statutory law and be tied to objective triggers(e.g. total AUM, or use of leverage) so it automatically applies without bureaucratic discretion.

Another Policy could involve mandating independent risk management functions within hedge funds to address conflict of interest between principles and agents which are investors and fund managers in this case. It is important to stress that international cooperation and Global Coordination is essential among regulators for effective oversight. This could include harmonising regulatory standards to prevent regulatory and financial arbitrage.

Implications for Future Research include evaluating the effectiveness of existing regulations in mitigating risks and analyzing more finance intensive case studies where regulatory interventions have successfully prevented crises.

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