ISSN 1392-1258. EKONOMIKA 2012 Vol. 91(1)

ALTERNATIVE INVESTMENT FUNDS: REGULATION, CHARACTERISTICS AND DEVELOPMENT IN LITHUANIA

Gytis Jarašius*
Vilnius University, Lithuania

Abstract: *This article deals with the operations of alternative investment funds (AIF) and their legislation in Lithuania. Currently, the AIF registered in Lithuania face difficulties, since the majority of them are not able to attract investors and are forced to discontinue their operations. Nevertheless, the size of the AIF capital in Lithuania is consistently growing and contributes to the increasing share of capital among all investment funds. The legislation of AIF on the global scale before the financial and economic crisis in 2008 was rather weak; nevertheless, currently this trend is changing, a new legislation is put in place in the EU and USA in order to tighten AIF legislation and to limit their operations. However, AIF registered in Lithuania are rather small; therefore, this trend will not have a significant influence on Lithuania.*

Key words: *alternative investment funds, private equity, hedge funds, real estate, legislation*

Introduction

One of the aims for Lithuania, imbedded in the national long-term development strategy, is the development of financial systems and capital market. Alternative investment funds (AIF) can use modern investment instruments and riskier investment strategies. Therefore, they could be analyzed as one of the ways to attain these aims. AIF are rather new; however, they are a robustly expanding investment product; their operations would expand the possibilities provided by the capital market in Lithuania and to a certain degree would prevent the outflow of the local capital.

Thus, it is important to analyse the investment policy pursued in Lithuania, its effect on AIF operating in the country, worldwide trends of AIF legislation and operations, since these trends with some time lag will also have to be implemented in Lithuania.

The Law on Collective Investment Undertaking (CIUL) in the Republic of Lithuania in March 1, 2008 opened possibilities for the legislation of alternative investment funds in Lithuania. It is important to analyse the operations of these funds, their influence on the economy, since they are already present in Lithuania, even though they still face difficulties in attracting investors. These issues are also significant due to the fact that

* *Corresponding author.*
Faculty of Economics Vilnius University, Saulėtekio Ave. 9, bld. II, LT-10222 Vilnius, Lituania;
e-mail: gytisj @gmail.lt

there are only a few Lithuanian authors who analyse AIF, and even they do not penetrate the entire AIF sector rather, they focus on separate types of funds. The legislation on AIF is also problematic, since CIUL provisions have been put in place only recently, they often change, and this impedes and limits the functioning of AIF.

The aim of this article is to analyse the current legislation of AIF and its changes in the recent years. In order to attain this aim, the author analyses the principles of AIF operations, the classification of these funds, CIUL and its changes, as well as the related establishment of AIF in Lithuania.

The author has analysed scientific literature and legislative acts related to historical data analysis, synthesis and interpretation.

1. Classification of alternative investment funds

There is no unanimous opinion on which type of investment should be perceived as alternative investments. It is difficult to apply a definition that would describe alternative instruments and the investment itself, since there is a plethora of alternative instruments. For these reasons, various researches differently outline the funds that belong to AIF.

Spangler and Paisner (2005) proclaim that three types of funds – hedge funds, private equity funds (PEF), and real estate funds (REF). – might be classified as AIF. According to Dönges (2008), alternative investments should include hedge funds, private equity, currencies and commodities. One of the distinctive features of alternative investments, which helps identify certain investment classes as alternative investments, is their insignificant correlation with common investment classes (stocks, obligations).

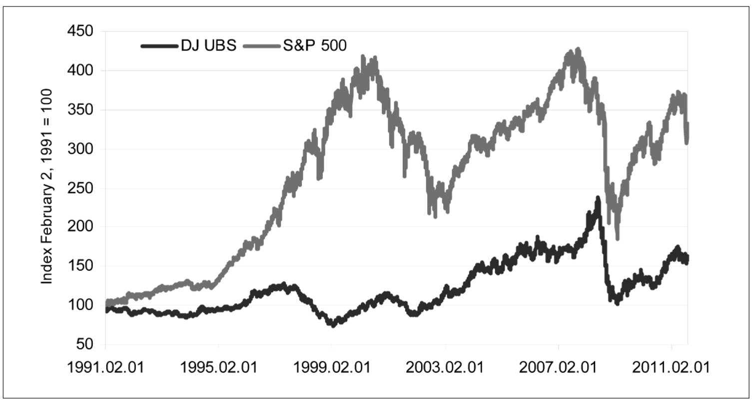
Private equity funds can be divided into two main types: buyout funds and venture capital funds (Metrick, Yasuda, 2008). Both types of funds perform similar operations, but their aims and the share of capital invested in a company differ. The venture capital fund invests more into unlisted, new companies, whereas buyout funds invest in a company by buying out the majority or all of its stocks, thus obtaining the right to manage the company. Leveraged buyout is a rather popular instrument when a company is purchased by using private capital only partially and the majority of funds are obtained through borrowing (Kaplan, Strömberg, 2008).

The majority of PEF have a limited duration: they are established for 10 to 12 years and then liquidated. Often investors are unable to withdraw their investment before the fund's liquidation term (such type of fund is called closed-ended). Even though the PEF duration term is set in advance, the term can be prolonged if the majority of stockholders agree (Kaplan, Strömberg, 2008; Ljungqvist, Richardson, 2003).

Hedge funds exist for the past 60 years; however, only during the past decade they have become more noticeable and their operations analysed, because their size started growing. Capital managed by hedge funds grew 44 times during the period 1980 to 1990 (Ackerman et al., 1999). Due to the variety of their activities it is difficult to define hedge funds. Nevertheless, they can be characterized by the following aspects: they are often not registered private investment community for rich and experienced investors (private and institutional) who use a certain financial leverage while pursuing their investment strategy (Becker, Doherty-Minicozzi, 2000). However, recently hedge funds legislation has become tighter, and this type of definition is no longer strict.

The definition **of *real estate funds'*** is rather broad and often attributed to various products which use real estate as their basis or which are related to real estate. Nevertheless, the main REF groups are open-ended REF, closed-ended REF, real estate investment trusts (REIT) and other real estate companies (Expert..., 2008). According to Bivainis and Volodzkienė (2008) who analyse REF and their place in the investment portfolio, REF are understood and analysed only as REIT. Even though REIT is very popular in the US and local publications often identify them as REF, this definition provides a very narrow interpretation of REF.

Commodities are commonly recognized as alternative investments. Even though this investment class could be recognized as alternative, the author does not agree that an investment fund formed on this basis could be recognized as AIF. Commodities funds become more popular, but the interest in commodities could be temporary as there is uncertainty in stock markets and economy. Commodity trading is mostly carried out through derivative instruments (in regulated or unregulated markets). Furthermore, indexes reflecting commodity prices show a strong positive correlation with stock market indexes; therefore, the funds that concentrate on commodity trading should not be labeled as AIF. The data presented in the first graph confirm that Dow Jones UBS Commodity Index and S&P 500 stock index prices have a strong positive linear correlation (correlation coefficient 0.58). Finally, the commodity trade could be interpreted as one of the hedge fund investment possibilities, and the funds invested in commodities could be perceived as one of the hedge fund types. In addition, hedge funds are willingly invested into commodities due to the possibility to hedge against inflation, price hikes, etc.



GRAPH 1. **Price changes in Commodity and S&P 500 indexes over the period 1991–2011** (compiled by the author on the basis of Yahoo Finance data)

Three types of funds – hedge funds, PEF and REF – should be included into AIF. These types of funds are the best reflection of the alternative investment sector, since they encompass all most popular fund types which have the greatest comparative share. Furthermore, only these AIF types are legislated by CIUL, confirming that the above-mentioned fund selection for AIF is relevant and proper while analysing the Lithuanian market.

2. Global and Lithuanian legislation on alternative investment funds

The main law on legislating investment funds in Lithuania is the law of Collective Investment Undertaking (CIU) in the Republic of Lithuania. The CIU law of 2003 extensively describes the investment funds that are allowed to function in Lithuania, their rights, duties and operations. The first version of the law does not mention AIF. Therefore, we can assume that during that period the Lithuanian market was not yet ready for a broad and complex diversity of investment instruments. The law also provides a possibility for creating a collective investment undertaking with a limited duration; the investment units or stocks of such undertaking could publicly be traded only in Lithuania. Nevertheless, as pointed out by Galiniene and Bumelyte (2008), this was a rather theoretical possibility, since the alternative investment scheme that could be used by investors would not be recognized in Lithuania.

The national long-term development strategy has a provision regarding the development of the capital market, its liberalization and full integration into the EU markets. In this respect, together with the need to develop the Lithuanian capital market and recommendations of the European Commission work groups, the CIU law was radically changed and improved.

The difference between the new version of CIUL (from March 1, 2008) and the former versions was in the conditions created for establishing special collective investment undertakings, such as private equity, real estate and alternative collective investment funds. This version of the law also consolidates the possibility to establish closed-end collective investment undertakings. Even though there were more changes made in CIUL, the majority of them did not regulate AIF. The changes in the law and their content are chronologically depicted in Table 1.

Special collective investment undertakings, according to CIUL can be open-ended and close-ended. Closed-ended funds or companies redeem their shares or other investment units only at the maturity date. Even though open-ended funds or companies have certain safeguards to protect them from unexpected wishes of investors to withdraw their funds (e.g., when investors want to withdraw a sum which exceeds 10% of their net asset value or other exceptional cases), the author would assume that close-ended funds would be more popular, since they provide a greater safety for fund managers, decrease liquidity risk and help to achieve aims more successfully without a fear of short-term fluctuations.

TABLE 1. **CIUL changes and their content**

No.	Date and number of the law	Changes	Remarks
1.	July 4, 2003 No. IX-1709	-	First version of the law
2.	October 25, 2007 No. X-1303	Alternative investment funds are legalized	Enforced from 2008-03-01
3.	June 19, 2008 No. X-1630	The definitions of financial, investment, derivative and money market instruments were expanded; the article referring to index investment funds was changed	No significant influence on AIF legislation
4.	March 19, 2009 No. XI-204	Definitions were changed, provisions of the article regarding the purchase and transfer of management company shares, additional clause regarding REF was added to CIUL (prohibition to exert a significant influence on the issuer), which was optional for REF.	Enforced from 2009-04-04 REF will have greater influence on the issuer
5.	June 3, 2010 No. XI-873	Definitions were changed, other articles were directly related to AIF. Part 2 of Art. 75 in the CIU law, which regulates REF operations, was appended	Changes ensure a clearer REF investment diversification principles

Source: compiled by the author based on the Law of Collective Investment Undertaking.

This is also confirmed by the history of AIF registered in Lithuania. There were 14 alternative investment funds registered by the end of the third quarter of 2011; only nine of them still operate, and only four of them are open-ended funds. The majority (3 out of 4) of open-ended funds are hedge funds. This could be explained by the specific nature of their operations: hedge funds asset positions are more liquid than those of PEF or REF, they are also more floating, therefore the withdrawals of separate investors do not have much influence on the fund. Furthermore, lower restrictions for redeeming fund units are applied to investors who invest into open-ended hedge funds. Therefore, this makes hedge funds more popular and opens possibilities for them to attract more investors.

The legislation is even more flexible for AIF devoted only to professional investors, announcing report data, and the fund's prospects are optional, which opens possibilities for a wider variety of investment units or stock types. It is important, that all special collective investment undertakings, with an exception of hedge funds, can be designed for a wide range of investors or for professional investors only. This signals that hedge funds are perceived as riskier than other AIF. The experience of AIFs registered in Lithuania shows that all without exception were devoted only to professional investors.

Table 2 summarizes the legislation set by CIUL for AIF devoted to professional investors. While discussing AIF, the author limits the discussion in this paper to the cases where these undertakings are devoted to professional investors since, according to the author, only then they can be perceived as true AIF. In other cases, when funds are accessible to a wide range of investors, their legislation is stricter and their freedom of operations is highly limited.

TABLE 2. **Characteristics of applied AIF legislation**

	Hedge funds	PEF	REF
Use of the leverage	Up to 200%	Up to 80%	Up to 75%
Diversification	Not strict	Not strict	Strict
Net asset value estimates	No less than once per the half-year	No less than once per the half-year	No less than once per the quarter
Possibility to loan	Up to 50%	Up to 50%	Forbidden
Type	Close-ended/open-end	Close-ended/ open-ended	Close-ended/ open-ended
Investors	Only professional	All	All

Source: compiled by the author based on the Law of Collective Investment Undertaking.

An analysis of the world-wide AIF experience showed that these funds, especially hedge funds, are barely legislated; they are often not required to provide information regarding their operations. Nevertheless, currently these trends are changing; there is a growing concern regarding AIF and the low degree of their legislation. The recent financial and economic crisis made us think about a stricter control of the financial sector, and AIF is not an exception.

As one of the main responses to the economic and financial crisis the European Commission has proposed a Directive on Alternative Investment Fund Managers, which came into force in May 2011. The target of the directive is to increase the AIF transparency by implementing sanctions against AIF managers and applying harmonized legislation standards. It can be perceived as the first attempt to create a full-scale AIF legislation and supervision system. The European Commission tried to encompass the greatest possible number of AIF managers in the directive. Nevertheless, the European Commission also considered different business structures and did not try to regulate the managers of smaller funds (e.g., the directive applies only to fund managers in cases when their capital value is greater than 100 million Euros. If the leverage is not applied and the initial five-year lock-in period of assets is applied, then the value of the capital has to be 500 million Euros or more). Only 30% of AIF managers are subject to legislation with these capital requirements; their capital represents about 90% of capital in AIF registered in the European Union. This directive also targets the main risk channels through a strict legislation of the main service providers for AIF.

The European Commission also proposed more measures to ensure a greater transparency in the AIF sector and to decrease the risk of this sector to financial system and economy. The provisions of this directive will also apply to AIF registered in

Lithuania as soon as they will be transferred to local legislative acts. However, due to the small market, it will be difficult for funds registered in Lithuania to reach the size of managed capital legislated by the directive.

Considerable changes were implemented in the USA as well. One of them was the Dodd–Frank Wall Street Reform and Consumer Protection Act implemented in July 2010. The purpose of this document is to improve the accountability and transparency of the financial system promote financial stability in the USA, forego the widespread idea of “too big to fail”; to protect the USA tax payers without providing financial assistance to financial institutions, to protect customers from abusive practices in financial services, etc. (Dodd-Frank..., 2010). Besides the legislation subjects mentioned above, much attention was directed towards AIF and especially hedge funds and PEF.

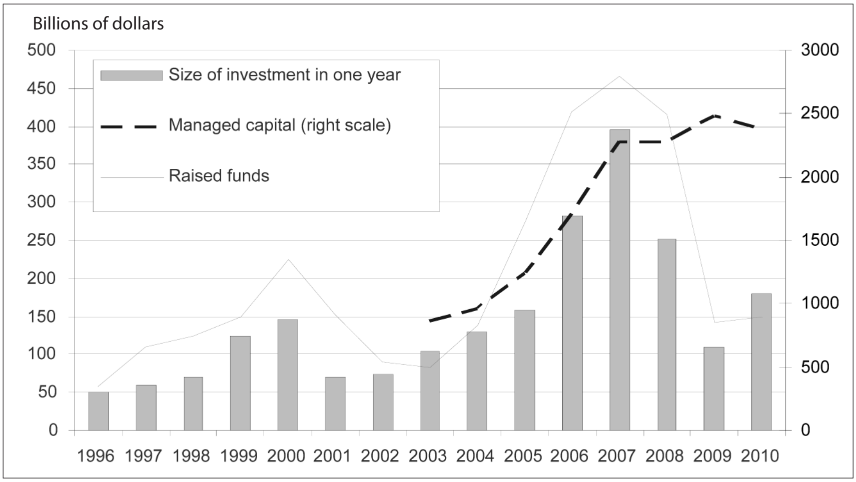
The new act requires hedge funds and PEF managers (consultants) to register in the Securities and Exchange Commission (SEC) and to provide information regarding transactions and investment portfolio (in cases when the value of the capital managed by the fund is more than $150 million). This information is needed to evaluate the systematic risk. Other provisions of the above-mentioned act will also influence AIF, even though they do not directly regulate AIF managers. Particularly, the legislation of derivative trading, in certain cases when AIF makes derivative transactions in the over-the-counter (OTC) market, funds would become subject to the legislation related to derivatives (Brown..., 2010).

There is a clear trend that the AIF legislation is tightening in all main economies of the world and their operations become more and more publicly disclosed. Most attention is given to large-scale funds, since they have the greatest influence on the economy. Nevertheless, for the same reason, recent legislative provisions will not have a great direct influence on Lithuania, with an exception of the fact that the EU directives will have to be incorporated int national laws.

3. Activities and development of alternative investment funds

Upon analysing the overall legislation on AIF, the author would like to discuss each AIF type separately, since there are differences not only in their operation and principles, but also the CIUL provisions have certain peculiarities applicable to different types of AIF.

An analysis of ***private equity funds*** has shown a rapid growth of their investments during 1996–2010. Nevertheless, this period saw also some downturns; a decrease in investment was observed after the year 2000, which could be explained by the general slowdown of the economic growth and a slump of the capital market. The shrinkage of attracted funds (funds collected by PEF from its participants, but not necessarily invested at the time) might have happened due to the fact that the raised funds in 2000 were not invested, and in the next years investors did not need these funds. A similar trend is visible in 2008 when the investment declined by nearly 40% – down to $251.4 billion. This



GRAPH 2. **Change in investment and raised funds of PEF over 1996–2010**

(Compiled by the author using Financial..., 2011b; IFSL..., 2005)

decline is also linked to uncertainties in the financial market and risk avoidance by the investors. Despite the fact that the financial and economic crisis has significantly slowed the growth of capital (this is attributed to a greater withdrawal of invested capital), the overall amount of capital is still growing.

PEF, like other AIF, can use financial leverage for their investment decisions. Therefore, their influence on the economy can be much greater than it can be determined from their managed capital and investment size.

A number of researchers suggest that companies backed by PEF operate better than the companies that were unable to attract venture capital. According to the "Global Insight" data, 17.6% of US GDP was generated by companies backed by PEF in the year 2006; these companies employed 9.1% of all private sector employees. The growth of sales and employment in these companies outpaced the overall growth of the market (their growth of sales has exceeded the growth of overall sales by 5.3%) (Venture..., 2007). A. Similar trend is also noticeable in Europe. According to data of 1990–1995, companies backed by PEF had greater sales, export and employment growth, as well as allocated more funds for research (Megginson, 2004). Alemanya and Martí (2005) show, that in Spain there might be venture-capital-backed companies where the positive influence of investment is felt on the growth of economic indicators (employment, sales, asset growth, paid taxes). According to these authors, these conclusions might not encompass all economic elements; however, similar outcomes can be observed in other countries as well, where PEF are well developed and operate for a longer time (Alemanya, Martí, 2005). Nevertheless, negative outcomes can also be observed in the presented numbers and researches. In unfavorable market and economic conditions, a high dependency on one source of financing (in this case PEF) can amplify the negative effect, which would be reflected on the economy as well.

Skeptical views towards PEF also exist. Kaplan and Strömberg (2008) notice that up to the end of 2007, 54% of transactions (out of 17171 transactions from 1970) by buyout funds using leveraged buyout were not yet completed. Therefore, we can assume that the positive impact of this type of PEF on the economy and especially the scope of its effect is not yet fully measured.

The negative trends are mostly associated with PEF which use leverage when buying out the majority of stocks of a company. In this case, the owners of the company lose their control over the company, and the new owners (PEF) can be interested only in short-term benefits, regardless of the long-term business goals and the company's long-term potential. This type of PEF usually sees the company as a set of assets, not as a tool for creating jobs. Even though jobs are created, they are usually intended for temporary employment and for low-skilled workers (Van der Burg, Rasmussen, 2007). PEF registered in Lithuania are restricted from using a greater leverage than 80% of owned capital, and their investment size is relatively small (when comparing the capital of all AIF registered in Lithuania with the capitalization of the Vilnius Stock Exchange, it amounted only to 0.41% in October 30, 2011) and their possibilities to buyout a larger company are very limited. At this moment, we can assume that the desire of PEF to obtain a maximum profit in the a short term from the obtained companies, despite important social factors, poses no risk in the current conditions in Lithuania. Nevertheless, the AIF investments are constantly growing (AIF-managed capital during the third quarter of 2011 amounted to almost 14% of all CIU-managed capital in Lithuania, while at the end of 2008 it reached over 1%) and PEF is gaining more weight; therefore, we may face the above-mentioned problems in the near future. For these reasons, it is important to discuss and be ready to take additional safeguarding measures to prevent the negative activities of these funds. An example of such prevention measure could be the requirement to reinvest part of realized profit, to ensure proper social and carrier guaranties to employees, etc.

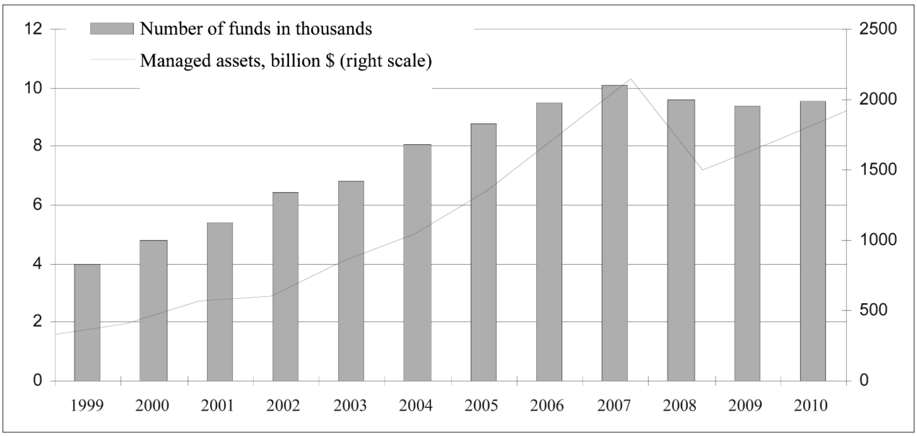
Despite the critics, research results show that PEF plays an important role in the economy and long-term development of the country. PEF provides funds (which can be hard to access through the usual capital raising) for young and promising companies, help them achieve their aims, and create competitive business environment in the country. Therefore, the development of PEF in the majority of countries is encouraged. While changing CIUL in Lithuania, it was stressed that the legalization of new types of funds will have a positive effect on capital markets, employment, small and medium size companies, since they will contribute to their promotion, sponsorship, development and increasing competitiveness (Lietuvos..., 2007).

An analysis of private equity CIU legislation in Lithuanian (Table 2) has shown that funds for professional investors have favourable conditions for their establishment and operations, there are no unnecessary restrictions and constraints, and the choice of investment instruments is rather wide (it is limited only by the development level of the market). This can be associated with a positive effect on the economy and developing companies.

The first PEF in Lithuania was established at the end of 2008; it was a close-ended private equity fund for professional investors "Sindicatum Private Equity Fund" (which later became "Synergos Private Equity Fund"). At the moment, the fund no longer operates, the licenses were suspended for its managers due to the recorded violations in the second quarter of 2011. Nevertheless, the fund gained 24.87 million Lt during the second quarter of 2010 (Vertybinių..., 2010). Two PEF were registered in Lithuania in the third quarter of 2011; one of them no longer operates (as mentioned above) and will be closed, and the second fund has not yet attracted investments, since it was established in the second half of 2011.

Hedge funds. Their growth trends in recent years are well reflected in Graph 3 which shows the scope of capital managed by the funds and their number. A rapid and continuous growth can be observed for both indicators up to the year 2008. Due to the global financial crisis, in the last few years there is a sharp fall when the capital of hedge funds shrunk by almost 30% in 2008 and amounted to only $1500 billion (Financial..., 2011a). The capital growth of hedge funds is observed in the years 2009 and 2010 due to recovering markets, better performance results, and increasing optimism among investors; however, it has not yet reached the level of 2007.

Garbaravicius and Dierick (2005) define several main ways hedge funds can have a positive effect on the economy. Although hedge funds are still relatively small, their participation in the markets adds liquidity, since hedge funds often take an opposite



GRAPH 3. **Capital managed by Hedge funds and their number, 1999–2010.**

(Compiled by the author using Financial..., 2011a) position than the market trend; they can use leverage while forming a portfolio and have possibilities to change their position more often than regular funds. While using their arbitrage strategies, they equalize prices in different markets. Therefore, we can say that they help the integration of financial markets. Active participation of hedge funds in the market contributes to the development of better risk management methods and helps spread the risk among the market participants. Due to a small correlation between hedge funds and stocks, stock indexes (according to the data of 1994–2004), in most cases the correlation coefficient was only 0.2–0.3 (Garbaravicius, Dierick, 2005)); hedge funds provide wider diversification possibilities for investors.

According to the explanatory note of the Lithuanian Ministry of Finance regarding the CIUL project changes, a wider selection for investors and better diversification possibilities are identified as benefits of hedge funds to financial markets. Hedge funds, due to their specific operations, often act as leading in various financial and investment innovations; therefore, these funds promote professionalism among investment managers and the development of financial markets.

Nevertheless, much more often hedge funds are perceived negatively as the ones creating rather high risks to financial markets and economy. Hedge funds often use leverage; therefore, even relatively small price fluctuations can create negative consequences to the fund, when it will have to liquidate its positions, and this in turn would affect the entire market if the fund is big enough. Garbaravicius and Dierick (2005) also point out that brokers of banks or investment companies might use similar strategies to hedge funds; such actions would further amplify the negative effect on the market in stressful situations.

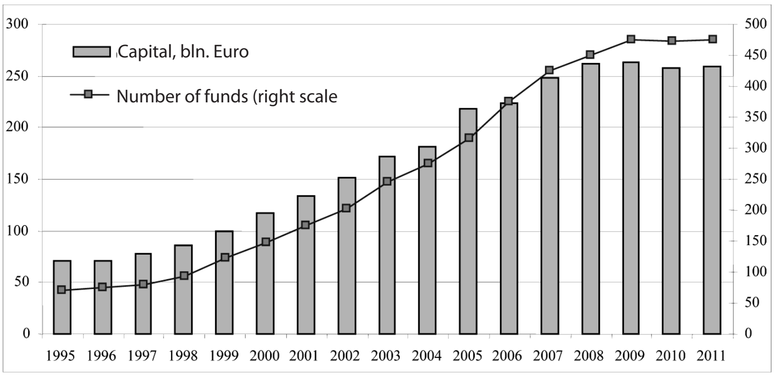
Hedge fund operations might endanger financial institutions as well, since funds use intermediaries' services while performing their operations. In these cases, financial institutions (banks, broker companies, etc.) become their intermediaries. According to Stulz (2007), hedge funds create a credit risk to banks in several ways: while borrowing, performing transactions with stocks; also, funds often act as the opposite side of transaction in the trade of derivatives.

At the end of the third quarter of 2011, three hedge funds operated in Lithuania and all of them already had attracted investments. Overall, five hedge funds were registered in Lithuania since the second quarter of 2008, but two of them had to discontinue operations. According to the data of the third quarter of 2011, hedge funds collectively managed 8.02 million Lt of capital which amounts to 1.6% of the overall capital managed by CIU in Lithuania (Vertybinių..., 2011)

Hedge funds are legislated similarly to private equity CIU. Nevertheless, an important difference is that hedge funds can use their own account for borrowing, but the maximum loan amount cannot exceed 200% of the net asset value. An analysis of literature has shown that the average leverage in the global hedge fund sector in 1999–2010 did not exceed 70% (average leverage was somewhat more than 40%) of the managed capital. In uncertainty conditions, this indicator amounted to only 10% in the financial markets. The CIUL limits the possibilities of hedge funds to obtain loans higher than 200% of the net asset value; in author's opinion, this number is rather high and should be reduced. Such limitation is not necessary for the little liquidity and small size of the Vilnius Stock Exchange, together with the current uncertainty in the world's and local financial markets. Limiting the maximum allowed leverage of hedge funds or regulating the leverage size in legislative acts without mentioning its size in the law would be a proper decision in Lithuania. This would provide more flexibility in the times of uncertainty to change the size of the leverage and to protect the local financial system.

Data regarding ***real estate funds'*** operations are very fragmented and often contradictory due to the differences in definitions and interpretations of the object. Nevertheless, these data can help us form a better understanding of the REF market. The number of unlisted REF registered in Europe and the regarding their managed capital value are presented in Graph 4. The consistent growth of their managed capital and the number of funds starting from 2008 has slowed and eventually stopped completely; this might be caused by the financial and economic crisis (2007), which primarily affected the real estate sector. The estimates show that the REF market was 1.2 trillion Euros in 2007 (estimate of the market value of real estate companies' stocks). Due to the leverage, which on average accounts for about 40% of this sector, the value of available capital is significantly higher and could reach as much as 2.1 trillion Euros (Eichholtz, Kok, 2007).

Regarding the REF situation in Lithuania, we could mention that Lords AB Baltic Fund I was established in June 2009 and was managed by Lords LB Asset Management. The same company later established three more REF: Lords LB Opportunity Fund I,



GRAPH 4. **Capital managed by European real estate funds, billion Euro**

(Compiled by the author using European..., 2011)

Lords LB Opportunity Fund II, and Lords AB Baltic Fund II. The latter one has not yet attracted investment, since it was established in the third quarter of 2011. The managed capital of these four REF amounted to 64.16 million at the end of the fourth quarter of 2011, which is 12.4% of all the CIU-managed capital (Vertybinių..., 2011).

The new revised edition of CIUL, presented by the Ministry of Finance of the Republic of Lithuania, states that REF will provide possibilities for private investors to indirectly invest their assets in land, buildings and other real estate in relatively small amounts (Lietuvos..., 2007). It is doubtful whether this will provide possibilities for a wider range of investors since the minimum investment amount into currently registered REF is 50 thousand Euros. The lower degree of legislation applies to REF which focus only on professional investors, therefore REF are unlikely to reduce the minimum investment amount (the minimum investment amount of funds oriented only towards professional investors cannot be lower than 50 thousand Euros). This is also confirmed by REF operations in Lithuania. Three REF, which have already attracted investment, have 77 investors overall, which is a rather small number (even thought REF have attracted the greatest number of investors among all three AIF types).

The Real estate CIU is legislated similarly to other AIF types. Tighter legislation is related only to the purchase and valuation of a fund's property. This can be due to the specifics of REF operations and investment objects. REF for professional investors must obtain property valuation from one independent real estate valuer before purchasing real estate (he cannot be an employee of the company), whereas property valuation from a foreign independent real estate valuer must be obtained before purchasing real estate objects abroad. Furthermore, a real estate CIU cannot purchase or sell real estate property for the price significantly differing from the valuation price (15% difference from valuation price) (Lietuvos..., 2003). There are discussions whether such a limitation is constructive, since funds are profit-seeking organizations and willingly should not try to manipulate market prices, because they would suffer losses (this would hold true if a real estate CIU does not try to pursue illegal activities). The law leaves exceptions for real estate CIU to purchase real estate objects which are priced at a greater difference than 15% of their value; however, in this case the purchase motives must be identified to the Securities Commission of the Republic of Lithuania (Lietuvos..., 2003).

Furthermore, additional diversification provisions apply to REF. They ensure that a REF does not become a regular fund without pursuing specific operations of regular funds. Although a REF has the right to undertake all other investments permitted to other special CIU funds, the REF capital must include at least four separate real estate objects. This provision does not apply only during the first four years after the fund's establishment. The first REF established in Lithuania was Lords AB Baltic Fund I, which had accumulated 24.87 million Lt of capital at the end of the first quarter of 2010, but all of them were invested into debt, stock and other instruments not related to real estate.

Therefore, it is not surprising that the fund's results are not impressive and similar to regular money market funds' results. The strategy of the fund is surprising, since this fund was established for only five years, with the possibility to prolong this term by two years; a delay in undertaking real estate investments might lead to a different than expected results (expected profitability indicated in the fund's rules is 18–20%).

Since REF are attractive to investors (the majority among all AIF are REF) and we can expect their further development in the future, it is imperative to ensure prevention of possible speculations with real estate and conditions for "price bubbles" to form. For these reasons, stricter requirements for REF are well-justified and compulsory. Also, due to the popularity of REF, it is necessary to protect investors from presumptive unfair actions of fund managers.

Conclusions

Conclusively, the development of AIF legislation in Lithuania shows that the process was not an accidental, rather consecutive and logical decision to keep up with the EU regulations while also implementing the aims related to the local capital market and listed in the national strategy. The permission for register AIF in Lithuania expands the possibilities of the capital market and provides more freedom to investors to diversify their investments. Therefore, we can assume that it helps retain more capital in Lithuania, which could otherwise pour to similar funds of other countries. These funds are also factors in the market liberalization process; they foster the culture and sophistication of investment.

AIF in Lithuania are still new, therefore it is difficult to see whether all aims (expansion of possibilities for capital market, greater diversification possibilities) that were targeted during legalization of these funds are achieved. These aims are expected to be met, if AIF legislation and the pursued policy were applied correctly. The author of this article regards the policy in related to legalization and legislation of AIF in Lithuania as wise, since this policy will stimulate integration into other EU markets and retain capital in the country. Although the CIUL provides a rather reliable legislation of funds and prevents many threats, some of the provisions (related to property valuation for real estate funds at purchase, high leverage allowed to hedge funds) are seen as excessive.

It is rather important not to disregard the threats of AIF for financial markets and the country's economy and to constantly improve their legislation with respect to global and local trends. The AIF registered in Lithuania do not constitute a greater part of investments. Nevertheless, these funds are robustly expanding their activities in Lithuania (their capital in the third quarter of 2011 was about 14% of all CIU capital in Lithuania), and it is likely that in the future their share of investments will increase and we will have to face additional challenges. In order to better secure the economy from short-sighted profit threats posed by private capital funds, it is crucial to consider the introduction of additional safeguards (for instance, reinvestment of the profit share) which would, at least partially, prevent this type of danger. Additionally, the developing and expanding REF require law makers to sustain their proper legislation level and avoid simplification of the requirements related to diversification and asset management in order to circumvent speculations and artificial raising of real estate prices.

REFERENCES

Ackermann C., McEnally R., Ravenscraft D. (1999). The performance of hedge funds: risk, return, and incentives. The Journal of Finance, Vol. 54, No. 3, p. 833–874.

Alemanya L., Martí J. (2005). Unbiased estimation of economic impact of venture capital backed firms. EFA 2005 Moscow Meetings Paper, 33 p.

Becker B., Doherty-Minicozzi C. (2000). Hedge Funds in Global Financial Markets. 104 p.

Bivainis J., Volodzkienė L. (2008). Nekilnojamojo turto investiciniai fondai: vieta investicinių fondų įvairovėje. Verslas: teorija ir praktika, 9 tomas, Nr. 3, p. 149–159.

Brown S., Lynch A., Petajisto A. (2010). Hedge funds after Dodd-Frank. Retrieved from http://w4.stern.nyu.edu/blogs/regulatingwallstreet/2010/07/hedge-funds-after-doddfrank.html

Dodd-Frank Wall Street Reform and Consumer Protection Act (2010). Public Law, p. 111–203. Retrieved from http://www.gpo.gov/fdsys/pkg/PLAW-111publ203/content-detail.html

Dönges T. (2008). Besteuerung privater Kapitalanlagen: Mit traditionellen und alternativen Investments zur steueroptimalen Depotstruktur. Wiesbaden: Gabler. 207 p.

Eichholtz P., Kok N. (2007). The EU REIT and the Internal Market for Real Estate. 85 p.

European Association for Investors in Non-listed Real Estate Vehicles (2011). INREV Vehicles Database Analysis. 21 p.

Expert Group Report: Open Ended Real Estate Funds (2008). Retrieved from http://ec.europa.eu/internal_market/investment/docs/other_docs/expert_groups/report_en.pdf

Financial Market Series: Hedge Funds 2011 (2011a). The City UK. 12 p.

Financial Market Series: Private Equity 2011 (2011b). The City UK. 12 p.

Galinienė B., Bumelytė J. (2008). Development of Real Estate Funds in Europe and Lithuania. Ekonomika, Nr. 83, p. 58–70.

Garbaravičius T., Dierick F. (2005). Hedge funds and their implications for financial stability. ECB Occasional Paper Series, No. 34, p. 76.

IFSL Research: Private Equity 2005 (2005). International Financial Services, London. 8 p.

Yahoo Finance. S&P 500 indekso duomenys. Retrieved from http://finance.yahoo.com/q/hp?s=^GSPC

Kaplan S. N., Strömberg P. (2008). Leveraged buyouts and private equity. NBER Working Paper, No. 14207, 40 p.

Lietuvos Respublikos Finansų ministerijos aiškinamasis raštas „Dėl Lietuvos Respublikos Kolektyvinio investavimo subjektų įstatymo pakeitimo įstatymo projekto“. (2007). 2007 m. rugpjūčio 16 d., Nr. XP-2442.

Lietuvos Respublikos Kolektyvinio investavimo subjektų įstatymas Nr. IX-1709 (2003). Valstybės žinios, Nr. 74-3424.

Lietuvos Respublikos Kolektyvinio investavimo subjektų įstatymo pakeitimo įstatymas Nr. X-1303 (2007). Valstybės žinios, Nr. 117-4772.

Lietuvos Respublikos Kolektyvinio investavimo subjektų įstatymo 2, 60, 62 straipsnių ir įstatymo priedo pakeitimo ir papildymo įstatymas Nr. X-1630 (2008). Valstybės žinios, Nr. 75-2922.

Lietuvos Respublikos Kolektyvinio investavimo subjektų įstatymo 2, 5, 10, 22, 41, 57, 58, 73, 90, 105 straipsnių bei priedo pakeitimo ir papildymo įstatymas Nr. XI-204 (2009). Valstybės žinios, Nr. 38-1443.

Lietuvos Respublikos Kolektyvinio investavimo subjektų įstatymo 1, 2, 6, 7, 9, 10, 15, 16, 25, 28, 34, 65, 71, 74, 75, 79, 84, 85, 93, 94, 95, 96, 109, 110 straipsnių ir VIII skyriaus pavadinimo pakeitimo ir papildymo įstatymas Nr. XI-873 (2010). Valstybės žinios, Nr. 71-3550.

Lietuvos Respublikos Seimo nutarimas „Dėl Valstybės ilgalaikės raidos strategijos“ Nr. IX-1187 (2002). Valstybės žinios, Nr. 113-5029.

Ljungqvist A., Richardson M. P. (2003). The Investment Behavior of Private Equity Fund Managers. 38 p.

Megginson W. L. (2004). Toward a global model of venture capital? Journal of Applied Corporate Finance. Vol. 16, No. 1, p. 8–26.

Metrick A., Yasuda A. (2008). The economics of private equity funds. Swedish Institute for Financial Research Conference on the Economics of Private Equity Market. 57 p.

Spangler T., Paisner B. L. (2005). A Practitioner's Guide to Alternative Investments Funds. London: City & Financial Publishing. 247 p.

Stulz R. M. (2007). Hedge funds: past, present and future. Fisher College of Business Working Paper Series, No. 2007-03-003. 39 p.

Uždaro tipo nekilnojamojo turto investicinio fondo „Lords LB Baltic Fund I“ taisyklės (2010). Retrieved from http://www.vpk.lt/new/documents/rules-lords-lb-baltic-fund-I.2010-03.pdf

Van den Burg I., Rasmussen P. N. (2007). Hedge funds and private equity: a critical analysis. Socialist Group in the European Parlament. 250 p.

Venture Impact: The economic importance of venture capital backed companies to the U.S. economy (2007). Global Insight. 24 p.

Vertybinių popierių komisija (2010). Lietuvos Respublikos kolektyvinio investavimo subjektų 2010 m. II ketvirčio veiklos apžvalga. 11 p.

Vertybinių popierių komisija (2011). Lietuvos Respublikos kolektyvinio investavimo subjektų 2011 m. III ketvirčio veiklos apžvalga. 16 p.