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## *SEC and CFTC Propose Private Fund Adviser Reporting Form*

BY THE INVESTMENT MANAGEMENT PRACTICE

On January 25, 2011 and January 26, 2011, the U.S. Securities and Exchange Commission (the "SEC") and the U.S. Commodity Futures Trading Commission (the "CFTC," and collectively with the "SEC," the "Commissions") jointly proposed the adoption of Form PF (the "Proposal") to implement certain provisions of Title IV of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").<sup>1</sup> The information to be collected on Form PF is intended to assist the Financial Stability Oversight Council (the "FSOC") in monitoring the potential systemic risks posed by private funds.

The proposed SEC rule<sup>2</sup> would require SEC registered investment advisers that advise one or more "private funds"<sup>3</sup> ("Private Fund Advisers") to report certain risk, leverage and financial information regarding those private funds on the newly created Form PF. The proposed CFTC rule<sup>4</sup> would require Private Fund Advisers that are also registered as commodity pool operators and/or commodity trading advisors with the CFTC to file Form PF in respect of any private funds advised by such dual registrants.

Under the Proposal, information reported on Form PF would remain confidential, although the information would be available to the Commissions generally, including for the purposes of rulemaking, examinations, investigations and investor protection efforts. Form PF would be filed electronically through a yet-to-be determined system.

### **Proposed Reporting Requirements**

The proposed reporting requirements for Form PF separate Private Fund Advisers into two broad groups: Large Private Fund Advisers (defined below) and all other advisers ("Small Private Fund Advisers"). Membership in one of these groups would determine the amount of information required to be reported and the frequency of the reporting by the adviser. It is anticipated that most Private Fund Advisers would be regarded as Small Private Fund Advisers and therefore subject to the lower reporting requirements.

Most Private Fund Advisers would be required to file Form PF annually within 90 days of their fiscal year end and to provide limited information regarding their operations and the private funds they advise. Under the proposed rules, certain Large Private Fund Advisers would have to file Form PF on a calendar quarterly basis within 15 days of quarter-end and provide more detailed reporting (as described below). Such additional reporting would be required for any Large Private Fund Adviser managing collectively at least \$1 billion in assets in one of the following categories: Hedge Funds,<sup>5</sup>

Liquidity Funds (i.e., unregistered money market funds),<sup>6</sup> or Private Equity Funds.<sup>7</sup> All Private Fund Advisers managing Hedge Funds would be required to make certain additional disclosures.

In calculating its assets under management for purposes of determining whether it qualified as a Large Private Fund Adviser, a Private Fund Adviser would be required to aggregate (1) the assets of managed accounts advised by the adviser that pursue substantially the same investment objectives and strategies and invest in substantially the same positions as the private fund<sup>8</sup> and (2) the assets of that type of private fund advised by any of the adviser's "related persons."<sup>9</sup> The proposed rules explain that the aggregation requirements are designed to prevent an adviser from avoiding the proposed large private fund adviser reporting requirements by restructuring the manner of providing private fund advice internally within the private fund manager group. As proposed, if a Private Fund Adviser's principal office and place of business are outside the United States, the adviser could exclude any private fund that during the last fiscal year was neither a United States person nor offered to, or beneficially owned by, any United States person.<sup>10</sup>

### **Information Required to Be Disclosed on Form PF**

Proposed Form PF has four sections and would serve as a joint form for the SEC and the CFTC only with respect to Sections 1 and 2. The SEC has separately proposed Sections 3 and 4. Section 1 would be required for all Private Fund Advisers and Sections 2, 3 and 4 would be required for Large Private Fund Advisers as well with respect to their Hedge Funds (Section 2), Liquidity Funds (Section 3), and Private Equity Funds (Section 4).

#### ***Section 1 – All Private Fund Advisers***

All Private Fund Advisers would be required to disclose information regarding each private fund they manage, including total and net assets under management, aggregate notional value of derivative positions, borrowings and leverage, creditors and counterparties, investor concentration and fund performance on a monthly and quarterly basis. Private Fund Advisers managing Hedge Funds would also be required to report additional information regarding investment strategy, counterparty exposure and trading and clearing practices.

#### ***Section 2 – Large Hedge Fund Advisers***

Large Private Fund Advisers managing at least \$1 billion in Hedge Funds would be required to provide information on an aggregated basis regarding exposure by asset class in different securities and commodities (e.g., different types of equities, fixed income securities, derivatives, and structured products), the duration of fixed income holdings, geographical concentration and turnover of the aggregate portfolio. In addition, for each Hedge Fund having a net asset value of at least \$500 million (a "Qualifying Hedge Fund"),<sup>11</sup> Large Private Fund Advisers would be required to report the same information noted above for each Qualifying Hedge Fund, as well as information concerning portfolio liquidity, position concentration, collateral practices, risk metrics (including, if regularly calculated, value at risk ("VaR") metrics), financing information, borrowing and derivatives exposure and the identity of (and clearing relationships with) the three central clearing counterparties to which the Qualifying Hedge Fund has the greatest net counterparty credit exposure.

According to the SEC, the additional disclosure requirements are designed to assist the FSOC in monitoring and assessing the extent to which stresses (including leverage and unsecured exposures) at those hedge funds could have systemic implications by spreading to prime brokers, credit or trading counterparties, or financial markets.

**Section 3 – Large Liquidity Fund Advisers**

Large Private Fund Advisers managing at least \$1 billion in Liquidity Funds (including registered money market funds) would be required to provide information on the valuation methods used (e.g., amortized costs or penny rounding), types of assets, liquidity profile, certain information relevant to the risk profile of each fund, and the extent to which each Liquidity Fund has a policy of complying with all or aspects of the rules regulating registered money market funds (Rule 2a-7 under the 1940 Act). Section 3 also requires Large Private Fund Advisers to report any secured or unsecured borrowings (broken down by creditor type and maturity), investor concentration, investor liquidity and redemption policies in respect of their Liquidity Funds.

**Section 4 – Large Private Equity Fund Advisers**

Large Private Fund Advisers managing at least \$1 billion in Private Equity Funds would be required to disclose the extent of leverage incurred by their funds' portfolio companies, the use of bridge financing (including the identity of institutions providing the financing), weighted average debt-to-equity ratio of controlled portfolio companies, and the maturity profile of its portfolio companies' debt. Section 4 also requires the disclosure of a Private Equity Fund's investment in financial institutions, including the institution's name, debt-to-equity ratio and percentage beneficial ownership by the fund.

**Compliance Dates and Comment Period**

The SEC and the CFTC anticipate that the proposed rules requiring the filing of Form PF would have a compliance date of December 15, 2011, with the expectation that this would result in most Private Fund Advisers with a December 31 fiscal year end filing their first Form PF by March 31, 2012. Large Private Fund Advisers would be required to make their first Form PF filing by January 15, 2012.

The comment period for the Proposal ends on March 28, 2011.



*If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:*

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- <sup>1</sup> "Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF," SEC Rel. No. IA-3145 (January 26, 2011) (the "Release"). The CFTC is only proposing Parts 1 and 2 of Form PF. See <http://www.sec.gov/rules/proposed/2011/ia-3145.pdf> for a copy of the proposed Form PF attached to the Release.
- <sup>2</sup> Proposed Rule 204(b)-1 under the Investment Advisers Act of 1940, as amended.
- <sup>3</sup> Any issuer that would be an investment company as defined in section 3 of the Investment Company Act of 1940, as amended ('1940 Act') but for sections 3(c)(1) or 3(c)(7) of that act. Includes hedge funds, private equity funds, certain real estate funds, and venture funds.
- <sup>4</sup> Proposed CFTC Rule 4.27.
- <sup>5</sup> Any private fund that (1) has a performance fee or allocation calculated by taking into account unrealized gains; (2) may borrow an amount in excess of one-half of its net asset value (including any committed capital) or may have gross notional exposure in excess of twice its net asset value (including any committed capital); or (3) may sell securities or other assets short.
- <sup>6</sup> Any private fund that seeks to generate income by investing in a portfolio of short term obligations in order to maintain a stable net asset value per unit or minimize principal volatility for investors.
- <sup>7</sup> Any private fund that (1) is not a hedge fund, liquidity fund, real estate fund, securitized asset fund or venture capital fund and (2) does not provide investors with redemption rights in the ordinary course of business.
- <sup>8</sup> Solely with respect to Liquidity Funds, the SEC is proposing that private fund advisers combine liquidity fund and registered money market fund assets under management for purposes of determining whether the adviser meets the \$1 billion threshold. Registered fund assets, however, are not to be included in calculating a Private Fund Adviser's assets under management in Hedge Funds or Private Equity Funds.
- <sup>9</sup> "**Related person**" is defined generally as: (1) all of the adviser's officers, partners, or directors (or any person performing similar functions); (2) all persons directly or indirectly controlling, controlled by, or under common control with the adviser; and (3) all of the adviser's employees (other than employees performing only clerical, administrative, support or similar functions).
- <sup>10</sup> "**United States person**" is defined in proposed Rule 203(m)-1.
- <sup>11</sup> Calculated by aggregating any parallel managed accounts, parallel funds, funds part of the same master-feeder structure and treating any funds managed by related persons as though they were managed by the Large Private Fund Adviser.