

# Client Alert.

November 15, 2011

## Form PF: Systemic Risk Reporting for Private Fund Advisers

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The Commodity Futures Trading Commission and the Securities and Exchange Commission (together, the “Commissions”) issued final rules defining the systemic risk reporting obligations of private fund advisers on Form PF.<sup>1</sup> The new rules, issued October 31, 2011, implement Sections 404 and 406 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”) and are aimed at providing the information necessary for the Financial Stability Oversight Council to assess systemic risk to the financial system.

### WHO MUST FILE FORM PF

Section 1 of Form PF must be filed by advisers that:

- Are registered or required to be registered under the Investment Advisers Act of 1940<sup>2</sup>;
- Advise one or more private funds<sup>3</sup>; and
- Manage at least \$150 million of regulatory assets under management (“AUM”)<sup>4</sup> attributable to private funds as of the end of its most recently completed fiscal year.

Commodity pool operators and commodity trading advisers that satisfy the conditions described above must file Form PF with respect to any commodity pool they manage that is a “private fund” and may file Form PF with respect to any commodity pool they manage that is not a “private fund.”

In addition, certain large private fund advisers are required to provide more detailed information in sections 2, 3 and/or 4 of Form PF (as described below), and in some cases are required to file Form PF more frequently than smaller advisers. These large private fund advisers include:

- *Large Private Equity Fund Advisers:* Any adviser having at least \$2 billion in AUM attributable to private equity funds<sup>5</sup> as of the last day of the adviser’s most recently completed fiscal year.

<sup>1</sup> The Commissions’ final rules are available at <http://sec.gov/rules/final/2011/ia-3308.pdf>.

<sup>2</sup> Exempt reporting advisers under the Dodd-Frank Act’s new registration exemptions for advisers solely to venture capital funds or advisers solely to private funds with assets under management of less than \$150 million in the U.S. are not required to file Form PF.

<sup>3</sup> Private funds include “any issuer that would be an investment company, as defined in section 3 of the Investment Company Act of 1940, but for section 3(c)(1) or 3(c)(7) under that Act.” While most private equity funds rely on these exemptions, advisers to funds that rely on other exemptions (such as real estate funds relying on section 3(c)(5)(C)), would not be required to report on Form PF.

<sup>4</sup> For purposes of the AUM thresholds, Form PF uses the definition of “regulatory assets under management” that the SEC recently adopted in connection with the amendments to Form ADV, which measures AUM gross of outstanding indebtedness and other accrued but unpaid liabilities. The final rules provide additional requirements on how to determine the \$150 million threshold, and the instructions to Form ADV provide further details about calculating an adviser’s AUM. The instructions to Form ADV are available at <http://www.sec.gov/about/forms/formadv-instructions.pdf>.

<sup>5</sup> A “private equity fund” is defined as any private fund that is not a hedge fund, liquidity fund, real estate fund, securitized asset fund or venture capital fund and does not provide investors with redemption rights in the ordinary course. Form PF will provide definitions for the terms “real estate fund,” “securitized asset fund” and “venture capital fund.”

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- *Large Hedge Fund Advisers:* Any adviser having at least \$1.5 billion in AUM attributable to hedge funds<sup>6</sup> as of the end of any month in the prior fiscal quarter.
- *Large Liquidity Fund Advisers:* Any adviser managing a liquidity fund<sup>7</sup> and having at least \$1 billion in combined AUM attributable to liquidity funds and registered money market funds as of the end of any month in the prior fiscal quarter.

## INFORMATION REQUIRED TO BE REPORTED ON FORM PF

While the Commissions have not yet published the final Form PF, the following provides a brief summary of the information advisers will have to provide on Form PF. As described in the final rules, the Form will also specify how advisers should report private fund assets of related persons, sub-advised funds, funds of funds, master-feeder arrangements and parallel fund structures<sup>8</sup> to avoid duplicative reporting.

### Section 1 – Identifying Information, Performance and Beneficial Owners of Private Funds.

The first section of Form PF will be divided into three parts. Section 1a will require information regarding the adviser's identity and AUM. Section 1b will require advisers to provide information about each private fund that it manages, including:

- The fund's gross and net assets, the aggregate notional value of its derivative positions, and a breakdown of the fund's borrowings and creditors;
- The percentage of the fund's equity held by its five largest equity holders, and the percentage of the fund owned by certain types of investors;
- The value of the fund's investments in other private funds and the value of any parallel managed accounts managed alongside the fund;
- The annual performance results of the fund on a gross and net basis (and monthly/quarterly data if such information is already being calculated for the fund); and
- The assets and liabilities of the fund broken down by classification in the fair value hierarchy established under U.S. GAAP.

Section 1c will require additional basic information regarding hedge funds advised by the adviser, such as a description of the hedge fund's investment strategy, the percentage of the fund's assets managed using high-frequency trading strategies, trading and clearing practices, significant counterparty exposures (including the identity of counterparties) and the fund's activities outside the securities and derivatives markets.

<sup>6</sup> A "hedge fund" is generally defined as any private fund having one of three common characteristics of a hedge fund: (a) a performance fee that takes into account market value (which takes into account both realized and unrealized gains, except for performance fees or allocations the calculation of which may take into account unrealized gains solely for the purpose of reducing such fees or allocations to reflect net unrealized losses); (b) the ability to engage in high leverage; or (c) the ability to engage in short selling (except for short selling that hedges currency exposure or manages duration). Solely for purposes of Form PF, a commodity pool that is reported or required to be reported on Form PF is treated as a hedge fund. The SEC has excluded from the "hedge fund" definition vehicles established for the purpose of issuing asset backed securities ("securitized asset funds").

<sup>7</sup> A "liquidity fund" is defined as 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>8</sup> Advisers may report information regarding funds in a master-feeder or parallel fund structures in the aggregate or separately on Form PF, so long as they do so on a consistent basis throughout the Form.

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## **Section 2 – Information Provided by Large Hedge Fund Advisers.**

The Commissions tailored section 2 of Form PF to focus on relevant areas of financial activity related to large hedge funds that have the potential to raise concerns regarding systemic risk to the financial system. Section 2a will require certain aggregate information about the hedge funds the adviser manages (e.g., the value of assets invested in different types of securities and commodities, the duration, the weighted average tenor or 10-year bond equivalent of fixed income portfolio holdings, the value of turnover in certain assets classes, and a geographical breakdown of investments).

Section 2b will require certain additional information about any hedge fund that the adviser manages that has a net asset value of at least \$500 million as of the end of any month in the prior fiscal quarter. The questions in this section require reporting of the same information as that requested in section 2a, but on a per fund basis, and additional granular information about each fund, including information regarding the hedge fund's portfolio liquidity, holdings of unencumbered cash and concentration of positions, the fund's base currency, the fund's collateral practices with counterparties, whether the hedge fund cleared any trades directly through a central clearing counterparty, and data regarding certain hedge fund risk metrics and financing information.

## **Section 3 – Information Provided by Large Liquidity Fund Advisers.**

This section will require Large Liquidity Fund Advisers to provide information for each liquidity fund they manage, including such fund's portfolio valuation, valuation methodology as well as the liquidity of the fund's holdings. This section will also require an adviser to provide information regarding whether it manages these liquidity funds in compliance with certain provisions of Rule 2a-7 under the Investment Company Act of 1940. With respect to each liquidity fund, items B and C of section 3 will require the adviser to report the amount of such fund's assets invested in various types of instruments, information with respect to open positions that represent 5% or more of such fund's net assets and information regarding such fund's borrowings. Finally, item D of section 3 will require certain information regarding the fund's investors, including the concentration of the fund's investor base and liquidity of their various ownership interests.

## **Section 4 – Information Provided by Large Private Equity Fund Advisers.**

This section of Form PF requires that Large Private Equity Advisers report information about the private equity funds they manage, including information related to guarantees of portfolio company obligations and the leverage of the various portfolio companies controlled by such private equity funds. Reporting in section 4 relates largely to portfolio company holdings of managed private equity funds because those portfolio companies incur much of the leverage inherent in private equity structures. The Commissions limited reporting to controlled portfolio companies (rather than all portfolio company interests held by these funds) to ensure that advisers are able to obtain the relevant information without incurring substantial additional burdens.

## **CONFIDENTIAL TREATMENT OF FORM PF INFORMATION**

The Commissions acknowledged that the information that advisers must provide on Form PF may be highly confidential, the public disclosure of which could adversely affect the adviser, the funds they manage and their investors. In light of the sensitive nature of the information, the Commissions clarified that they do not intend to make public any Form PF information identifiable to any particular adviser or private fund. In addition, Section 404 of the Dodd-Frank Act amended the Advisers Act to preclude the Commissions from being compelled to reveal any such information except in very limited

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circumstances.<sup>9</sup> The Commissions, however, reserve the right to use any information provided on Form PF in any enforcement action related to a private fund adviser.

## FILING REQUIREMENTS AND TIMING

Advisers will be required to file Form PF electronically with the Investment Adviser Registration Depository (IARD) and pay a filing fee in an amount to be determined by the Commissions.

Large Private Equity Fund Advisers and smaller private fund advisers must file Form PF within 120 days of the end of such adviser's fiscal year. By contrast, Large Hedge Fund Advisers and Large Liquidity Fund Advisers must file Form PF on a quarterly basis, and must file within 60 days and 15 days, respectively, of the end of each such adviser's fiscal quarter. Advisers are not required to file Form PF with respect to any period that ended prior to the effective date of their registrations.

Although the final rules and Form PF will be effective on March 31, 2012, the Commissions are adopting a two-stage phase-in period for compliance with Form PF filing requirements. Assuming a calendar year or quarter, according to this two-step approach the filing dates will, generally, be as follows:

Stage 1: With a compliance date of June 15, 2012, most large hedge fund and liquidity fund advisers<sup>10</sup> will file their first Form PFs in the third quarter of 2012.<sup>11</sup>

Stage 2: With a compliance date of December 15, 2012, all other filers (including large private equity fund advisers<sup>10</sup>) will be required to file their first Form PF in the second quarter of 2013, based on information as of December 31, 2012.

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<sup>9</sup> The Dodd-Frank Act contemplates that Form PF data may be shared with other federal departments or agencies or with self-regulatory organizations for purposes within the scope of their jurisdiction.

<sup>10</sup> Large fund advisers include advisers with \$5 billion in AUM attributable to hedge funds, liquidity funds or private equity funds as of the fiscal quarter (or the fiscal year for private equity fund advisers) most recently completed prior to June 15, 2012.

<sup>11</sup> By contrast, if a large private equity fund adviser has a June 30 fiscal year and \$5 billion in AUM attributable to private equity funds as of June 30, 2012, such adviser would be required to file its first Form PF within 120 days following June 30, 2012.

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