Hogan Lovells

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Joint SEC-CFTC proposal would overhaul Form PF reporting

The U.S. Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC) proposed joint amendments to Form PF, a confidential reporting form required of certain SEC-registered investment advisers (RIAs) to private funds, on Wednesday, 10 August 2022. The amendments would enhance reporting requirements for all private fund advisers, hedge fund advisers in particular, and are designed to refine the federal government's ability to monitor systemic risk from private funds, including the use of leverage.

The proposed amendments, in short:

- enhance reporting of basic information about all advisers and the private funds they advise;
- clarify how all advisers should report complex structures, such as master-feeder and parallel fund structures;
- enhance reporting by large hedge fund advisers on "qualifying hedge funds" (i.e. those hedge funds with a net asset value of at least US$500 million);
- enhance additional reporting about all hedge funds, generally; and
- remove aggregate reporting for large hedge fund advisers.

The proposed amendments are available in full here, which includes a full draft amended version of Form PF. The public comment period will remain open through the later of (i) 60 days following publication of the proposing release on the SEC's website (i.e. 11 October 2022) or (ii) 30 days following publication of the proposing release in the Federal Register, whichever period is longer.

Background

The SEC adopted Rule 204(b)-1 under the U.S. Investment Advisers Act of 1940 (the Advisers Act) in 2011 to require Form PF, a non-public filing made by all RIAs that manage one or more private funds and that have over US$150 million in private fund assets under management, including those RIAs that are also registered with the CFTC as a commodities pool operator (CPO) or commodity trading advisor (CTA). The purpose of Form PF is to provide the Financial Stability Oversight Council (FSOC) with data to identify systemic trends in the private fund industry and corresponding risks to U.S. financial markets.

Most smaller private fund advisers are required to complete only Section 1 of Form PF, annually, within 120 days after the end of the RIA's fiscal year. But "large private equity advisers," defined as those with at least US$2 billion in private equity fund assets under management, are required to complete additional details in Section 4 of Form PF. Moreover, "large hedge fund advisers," defined as those with at least US$1.5 billion in hedge fund assets under management, are required to complete Section 2 on a quarterly basis.

Significant changes for all advisers

Although the proposal would impact hedge fund advisers more than other private fund advisers, the amendments impact some of the information that all private fund advisers provide under Form PF in Section 1, the section most widely applicable to advisers generally.

Among other things, the proposal addresses the following topics:

- *Calculation of AUM*. Generally, advisers are required to list their regulatory assets under management (AUM), calculated in the same manner as for Form ADV. The proposed amendments would require advisers to exclude the value of private fund investments in other internal private funds to avoid double counting of fund assets.
- *Type of private fund*. Form PF would require advisers to identify each reporting fund from a list of pre-identified options: (i) qualifying hedge fund (those with a net asset value in excess of US$500 million); (ii) non-qualifying hedge fund; (iii) liquidity fund (funds that seek to generate income through short-term investments to maintain a stable net asset value or otherwise minimize volatility); (iv) private equity fund; (v) real estate fund; (vi) securitized asset fund; (vii) venture capital fund; or (viii) "other." Advisers will also be required to indicate whether the fund is a "commodity pool," which is categorized as a hedge fund for Form PF purposes. Form PF would newly require advisers to report whether a fund operates as a UCITS or AIF in the European Union or markets itself as a money market fund outside the United States (and in which countries).
- *Master-feeder and parallel structures*. In line with new reporting instructions discussed below, advisers would be required to report components of master-feeder arrangements and parallel fund structures separately. Funds of funds would be required to report the value of a reporting fund's equity investments in both external and internal private funds.
- *Withdrawal and redemption rights*. All advisers would be required to report certain withdrawal and redemption rights. Many private funds severely limit withdrawal or redemption rights. Many hedge funds, in contrast, typically provide for such rights in some capacity, thereby making hedge funds more susceptible to market stress. Furthermore, each fund would indicate how often such withdrawal or redemption rights are permitted (from daily to annually).
- *Gross and net asset value*. In reporting each fund's gross and net asset values, Form PF would require advisers to report separately the value of unfunded commitments, which will help regulators understand more clearly if a particular fund has a significant amount of uncalled commitments to deploy for investment, as is typical early in the life of a private fund. Moreover, advisers who file quarterly updates – i.e. certain large hedge fund and liquidity fund advisers – would be required to report both gross and net asset value as of the end of each month, not just as of the end of each quarterly period.
- *Inflows and outflows*. All advisers would report new information about the reporting fund's activity, including new capital contributions (excluding contributions of already-committed capital), as well as actual withdrawals and redemptions, and distributions to all investors. Quarterly reporters will be required to provide this information on a monthly basis.
- *Borrowing information*. Form PF would also require advisers to report each private fund's "borrowings," including the value of each borrowing and the type of creditor for such borrowing (including whether such creditor is based in the United States and whether a "U.S. depository institution").
- *Beneficial ownership of reporting funds*. Currently, each private fund is required to report the approximate percentage of beneficial ownership by each of several categories of investor type. Private funds routinely collect this information from investors when they subscribe for interests during fundraisings. The amendments, however, would broaden these categories of beneficial ownership, by including separate categories for U.S. persons and non-U.S. persons not only for individuals (as is currently the case), but also for broker-dealers, insurance companies, non-profits, pension plans and banking or thrift institutions.
- *Fund performance*. Form PF requires advisers to provide each reporting fund's gross and net performance, as reported to current and prospective investors (on a monthly, quarterly and/or annual basis, depending on the nature of the adviser). Under the new rules, if the reporting fund's performance is reported to current and prospective investors as an internal rate of return (IRR) since inception, the adviser would in future report the IRR. The amendments would also require that if performance is reported to current and prospective investors in a currency other than U.S. dollars, advisers would be required to identify the currency and report the data using that currency.

Deeper changes for hedge funds

Section 1c currently requires hedge fund advisers to provide additional information about the hedge funds they advise. In addition to the changes described above for all advisers, the proposed amendments would require all hedge fund advisers to change how they report their investment strategies, including with respect to "digital assets," defined as assets that are issued and/or transferred using distributed ledger or blockchain technology, including "virtual currencies," "coins" and "tokens," and otherwise synonymous with "crypto assets." Hedge fund advisers would also provide deeper information as to counterparty risk.

Large hedge fund advisers reporting on qualifying hedge funds would be required to provide enhanced reporting on several topics throughout Section 2 of Form PF, including investment exposures, borrowing and counterparty exposure, market factor effects, currency exposure reporting, turnover, country and industry exposure, central clearing counterparty reporting, risk metrics, investment performance by strategy, portfolio correlation, portfolio liquidity, and financing liquidity. All hedge fund advisers – and especially large hedge fund advisers – should pay particularly close attention to the proposed changes to Form PF.

Changes in reporting instructions for complex structures

Form PF currently allows advisers to report certain complex structures either in the aggregate or separately, as long as they do so consistently. The proposed rules would eliminate the option for aggregate reporting, on the basis that such aggregation can obscure data about hedge funds.

Many global hedge funds (and other types of funds) feature a "master-feeder" structure, whereby the assets of two or more feeder funds, often an onshore and an offshore fund, flow into an aggregator vehicle. Many funds, likewise, feature one or more parallel funds for tax, regulatory or other legal purposes, which make investments together on a side-by-side basis. The proposed amendments to the Form PF instructions would require advisers to report separately each component of a master-feeder arrangement or a parallel fund structure.

Moreover, the proposed Form PF amendments would also change instructions for funds of funds by mandating that the reporting fund include the value of the its investments in other funds when responding to Form PF questions, unless otherwise instructed.

Imposing these changes, the SEC hopes, will improve data quality and comparability.

Earlier SEC proposal remains on SEC agenda

The SEC previously announced a set of proposed Form PF amendments on 26 January that, among other things, would lower the US$2 billion threshold to US$1.5 billion for "large private equity advisers" that complete Section 4 of Form PF, and would require additional reporting from large hedge fund advisers and large private equity advisers, in some cases within one business day.

In addition, the January proposal would amend Section 4 of Form PF to gather additional information from large private equity advisers regarding fund strategies, use of leverage and portfolio company financings, controlled portfolio companies and their borrowings, fund investments in different levels of a single portfolio company's capital structure and portfolio company restructurings or recapitalizations.

Conclusion

In addition to these two proposals to amend Form PF, the SEC in 2022 under chair Gary Gensler (who previously served as CFTC chair from 2009 to 2014) has also introduced new potential rules on cybersecurity practices, new restrictions and regulations on private funds, enhanced disclosures and protections relating to special purpose acquisition companies (SPACs), and a new framework for disclosures on environmental, social and governance (ESG) standards.

We continue to monitor ongoing SEC rulemaking, and we will provide updates as additional proposals emerge and/or the SEC adopts final rules regarding these proposals.

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