

## SEC and CFTC Approve Systemic Risk Reporting on Form PF

As of October 31, 2011, the Securities and Exchange Commission and the Commodity Futures Trading Commission jointly approved proposed Rule 204(b)-1 under the Investment Advisers Act of 1940, which will affect managers of private equity funds, hedge funds, real estate funds and liquidity funds. Specifically, the Rule mandates that any investment adviser required to register with the SEC that advises one or more private funds with at least \$150 million in private fund assets under management must file Form PF.

This client alert provides a summary of Form PF, including a discussion of the following:

- Who is required to file;
- What must be disclosed;
- How to comply with filing; and
- The level of confidentiality afforded to those who must file.

As of October 31, 2011, the Securities and Exchange Commission (the “SEC”) and the Commodity Futures Trading Commission (the “CFTC”) jointly approved proposed Rule 204(b)-1 under the Investment Advisers Act of 1940 (the “Rule”). As adopted, the Rule made two concessions to the filing date requirements set forth in the Rule as originally proposed on January 26, 2011.

The Rule implements Sections 404 and 406 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”), which mandate that the SEC require reporting by certain private fund advisers to assist the Financial Stability Oversight Commission (“FSOC”) in assessing systemic risk in the U.S. financial system. The Rule will affect managers of private equity funds, hedge funds, real estate funds and liquidity funds.

### Who Is Required to File Form PF

Under the Rule, any investment adviser (whether inside or outside of the United States) required to register with the SEC that advises one or more private funds with at least \$150 million in private fund assets under management (“Private Fund Adviser”) must file Form PF. A “private fund” is defined as an issuer that would be an investment company as defined in Section 3 of the Investment Company Act of 1940 (the “Act”), but for section 3(c)(1) or 3(c)(7) of the Act. The Rule separates Private Fund Advisers that are “Large Private Fund Advisers” from all other Private Fund Advisers. Large Private Fund Advisers are those which:

- manage hedge funds<sup>i</sup> with US\$1.5 billion in assets,
- manage liquidity funds<sup>ii</sup> and have combined liquidity and registered money market funds of at least US\$1 billion, and
- manage private equity funds<sup>iii</sup> that collectively have at least US\$2 billion in assets.

The Rule exempts from the reporting requirements those Private Fund Advisers that rely on an exemption from registration created by the Dodd-Frank Act or are otherwise not required to register. Furthermore, if an adviser's principal office and place of business is outside the United States, the adviser may exclude any private fund that, during the adviser's last fiscal year, was not a U.S. person (as defined in Regulation S), was not offered in the United States, and was not beneficially owned by any U.S. person.

### **Disclosure Requirements**

All Private Fund Advisers would be required to report the following information annually:

- gross and net asset value of each private fund,
- monthly and quarterly performance data of each private fund,
- investor concentration,
- notional value of derivative positions, and
- total borrowings (including a breakdown of the fund's borrowings among U.S. and non-U.S. financial institutions and non-financial institutions).

Private Fund Advisers that manage hedge funds would also be required to report the following:

- investment strategies,
- the percentage of the fund's assets managed using computer-driven trading algorithms,
- significant counterparty exposure (including the identity of the counterparty), and
- trading and clearing practices.

All Private Fund Advisers must file Form PF annually within 120 days of the end of the fiscal year of such adviser, other than Large Private Fund Advisers, which must file as set forth below.

### **Additional Disclosure Obligations for Large Private Fund Advisers**

More detailed information is required to be reported by a Large Private Fund Adviser depending on what types of assets are managed by the adviser.

In the case of a managed hedge fund, a Large Private Fund Adviser must provide aggregate information about the hedge funds it advises, including aggregate market value of assets invested (on a short and long basis) in different types of securities and commodities, duration of fixed income portfolio holdings, assets' interest rate sensitivity, portfolio turnover rate and geographical breakdown of investments. Large Private Fund Advisers to hedge funds will be required to file Form PF within 60 days of the end of each fiscal quarter (instead of 15 days, as in the January 2011 original proposal).

In the case of a private equity fund, for each private equity fund managed, a Large Private Fund Adviser must provide information on borrowings and guarantees and provide disclosure on each fund's portfolio companies, including increased disclosure for financial industry portfolio companies and a breakdown of investments by industry and geography. Large Private Fund Advisers to private equity funds will be required to file Form PF within 120 days of the end of each fiscal year (instead of 15 days on a quarterly basis, as in the January 2011 original proposal).

## Confidentiality of Form PF

The Dodd-Frank Act requires that the SEC and CFTC share information reported on Form PF with the FSOC, subject to the confidentiality provisions of the Dodd-Frank Act.<sup>iv</sup> The SEC has indicated that it will create certain controls and safeguards to insure that the information contained in Form PF is provided to other parties only on a need-to-know basis and for regulatory purposes.<sup>v</sup>

## Compliance with Filing Form PF

Most Private Fund Advisers are required to begin filing Form PF following the end of their first fiscal year or quarter, as applicable, ending on or after December 15, 2012, which would result in their first filing in 2013.

However, certain Private Fund Advisers must begin filing Form PF following the end of their first year or fiscal quarter, as applicable, ending on or after June 15, 2012, including those which:

- manage hedge funds with US\$5 billion in assets, and
- manage private equity funds that collectively have at least US\$5 billion in assets.

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<sup>i</sup> "Hedge fund" is defined as any private fund (other than a securitized asset fund) that (1) has a performance fee or allocation calculated by taking into account unrealized gains (other than a fee or allocation the calculation of which may take into account unrealized gains solely for the purpose of reducing such fee or allocation to reflect net unrealized losses); (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 or enter into any similar transactions (other than for the purpose of hedging currency exposure or managing duration).

<sup>ii</sup> "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>iii</sup> "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.

<sup>iv</sup> Section 404 of the Dodd-Frank Act states that “[n]otwithstanding any other provision of law, the Commission [SEC] may not be compelled to disclose any report or information contained therein required to be filed with the Commission [SEC] under this subsection” except to Congress upon agreement of confidentiality.

<sup>v</sup> Not only may the SEC use Form PF information in an enforcement action, but section 404 of the Dodd-Frank Act also provides that nothing may prevent the SEC from complying with a request for information from any other federal department or agency or any self-regulatory organization of the United States requesting the report or information for purposes within the scope of its jurisdiction or an order of a court of the U.S. in an action brought by the U.S. or the SEC. However, any such department, agency or self-regulatory organization would be exempt from being compelled under the U.S. Freedom of Information Act to disclose to the public any information collected through Form PF and must maintain the confidentiality of that information consistent with the level of confidentiality established for the SEC in section 204(b) of the Advisers Act. The SEC also states that it intends to require, prior to sharing any Form PF data, that any such department, agency or self-regulatory organization represent to the SEC that it has in place controls designed to ensure the use and handling of Form PF data in a manner consistent with the protections established in the Dodd-Frank Act.