

SEC PROPOSES AMENDMENTS TO FORM PF TO INCREASE OVERSIGHT OF PRIVATE FUNDS

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- On 26 January 2022, the U.S. Securities and Exchange Commission (SEC) proposed amendments to Form PF, the confidential reporting form required to be filed by certain advisers to private funds.
- If adopted, the proposed amendments would require large hedge fund advisers and private equity advisers to file current reports within one business day of the occurrence of certain significant events. They would also expand reporting obligations for large private equity advisers and large liquidity fund advisers.
- The proposal comes a decade after Form PF was first adopted in the wake of the 2008 financial crisis and are reflective of a broader effort by the SEC under Chairman Gary Gensler to increase transparency and oversight in the private fund industry.

On 26 January 2022, the SEC [proposed amendments to Form PF](#) (the Proposal), the confidential reporting form required to be filed by certain advisers to private funds.¹ If adopted, the proposed amendments would: (i) add new current reporting requirements for large hedge fund advisers and private equity advisers (supplementing their existing quarterly and annual reporting obligations); (ii) lower the annual reporting threshold for large private equity advisers and require these advisers to provide additional information to the SEC about the private equity funds they advise; and (iii), similar to recently proposed amendments to Form N-MFP (the public reporting form used by money market funds), revise how large liquidity advisers report certain operational information and assets, as well as portfolio, financing, and investor information. The Proposal is designed to improve the SEC's and the Financial Stability Oversight Council's (FSOC) ability to monitor systemic risk, including by collecting additional data points the SEC staff can use to evaluate private fund advisers for potential examination.

The Proposal comes on the heels of a speech by Chairman Gensler to the Institutional Limited Partners Association (ILPA) in November 2021, in which he expressed his views on the need for increased competition and transparency in the private fund industry.² In the speech, Chairman Gensler specifically called for enhancements to private fund advisers' reporting requirements to include more granular and timelier information. He also suggested general reforms to promote more robust disclosure by private fund advisers in connection with fees and expenses, side letters, performance metrics, and conflicts of interest. The Proposal represents concrete and swift action by the SEC to manifest Chairman Gensler's agenda, and it signals momentum for related rulemaking proposals to come. Additionally, a day after the Proposal was released, the SEC's Division of Examinations (EXAMs) published a [risk alert](#) highlighting observations in recent examinations of private fund advisers, illustrating many of the themes raised in Chairman Gensler's ILPA speech. Taken together, the Proposal, Chairman Gensler's speech, and the risk alert signal a coordinated effort by SEC staff to foster

significant regulatory changes in the private funds industry. To date, the SEC has already issued additional proposals targeting the private fund industry and managers should be prepared to see other initiatives from the SEC along these lines.³

The SEC voted 3-1 to approve the Proposal.⁴ Comments on the Proposal must be submitted to the SEC staff within 30 days of its publication in the Federal Register.⁵ As of the publication date of this article, the Proposal has not yet been published in the Federal Register.

I. PROPOSED AMENDMENTS

The SEC requires that certain advisers to privately offered 3(c)(1) and 3(c)(7) funds, including most hedge funds, private equity funds, and liquidity funds, complete Form PF to confidentially disclose certain information about the funds' operations.⁶ The proposed amendments to the Form would supplement advisers' existing reporting obligations by adding new current reporting requirements for large hedge fund advisers and all private equity advisers, expanding reporting obligations for large private equity advisers, and adding new reporting duties for large liquidity fund advisers.

A. New Current Reporting Requirements for Large Hedge Fund Advisers and All Private Equity Advisers

The most significant proposed changes to Form PF are the additions of sections 5 and 6 to add new current reporting requirements for large hedge fund advisers (advisers having at least US\$1.5 billion in regulatory assets under management attributable to hedge funds) and all private equity advisers that meet the US\$150 million reporting threshold, respectively. To supplement the existing quarterly or annual updating requirements, the proposed Form PF amendments would require advisers to report certain events to the SEC within one business day of their occurrence. The SEC believes that current reporting of these events will help its examination staff and the FSOC more quickly identify significant stress at a fund that could harm investors or signal risk in the broader financial system.

Under the proposed amendments, *large hedge fund advisers* would be required to report the following events within one business day of their occurrence:

- Extraordinary investment losses, which the SEC defines as a hedge fund's loss of 20 percent or more of its most recent net asset value over a rolling 10-business-day period;⁷
- Significant margin and default events, such as (i) a significant increase in a hedge fund's requirements for margin, collateral, or an equivalent (collectively, "margin"),⁸ (ii) a fund's margin default or inability to meet a call for margin, and (iii) a counterparty's margin default;⁹
- Any material change in the relationship between a hedge fund and a prime broker, such as material changes to the fund's ability to trade or a termination of the prime brokerage relationship;¹⁰
- Declines in a fund's unencumbered cash holdings of at least 20 percent over a rolling 10-business-day period;¹¹
- Any significant disruption or degradation of a fund's key operations, including (i) its investment, trading, valuation, reporting, and risk management capacity, (ii) its compliance with U.S. securities laws and regulations, and (iii) its ability to properly value its assets;

- Large withdrawal and redemption requests exceeding 50 percent of a hedge fund's most recent net asset value, netted against subscriptions and other contributions already received from and committed by investors; and
- A fund's inability to satisfy redemptions, or suspensions of redemptions, for more than five consecutive business days.

The proposed amendments also require *private equity advisers* to report certain events within one business day, including:

- The completion of adviser-led secondary transactions, defined as transactions by an adviser or its related persons that offer private fund investors the choice to (i) sell all or a portion of their interests in the private fund, or (ii) convert or exchange a portion of their interests in the fund for interests in another vehicle advised by the adviser;
- Any general partner clawback requiring a fund's general partner to return performance-based compensation to the fund;
- Any limited partner clawback of 10 percent or more of a fund's aggregate capital commitments;
- Removal of the adviser as the general partner or similar control person of a fund; and
- Investors' election to terminate the fund or its investment period.

Most portions of proposed sections 5 and 6 of Form PF would be completed by selecting check boxes and would not require narrative responses, although the SEC explains that private fund advisers could add explanatory notes if desired. Under the Proposal, advisers filing these current reports would not need to simultaneously file any other sections of Form PF.

B. Expanded Reporting Obligations for Large Private Equity Advisers

In addition to establishing new current reporting requirements for all private equity advisers, the proposed amendments also broaden the scope of section 4 of Form PF by expanding the definition of and requiring additional disclosures from large private equity advisers.

The SEC currently defines large private equity advisers as those with at least US\$2 billion in private equity assets under management as of the end of their most recently completed fiscal years. If adopted, the proposed amendments would lower this reporting threshold to US\$1.5 billion. The SEC expects this change will increase the percentage of the U.S. private equity industry covered by section 4 of Form PF from 67 percent to 75 percent based on committed capital, improving the SEC's ability to monitor systemic risk.

The proposed amendments also expand section 4 by adding new questions that require a *large private equity adviser* to disclose:

- A private equity fund's investment strategies;
- Whether any of a fund's portfolio companies was restructured or recapitalized following the fund's investment period;

- Whether the fund held an investment in one class, series, or type of securities of a portfolio company while another fund advised by the adviser or its related persons simultaneously held an investment in a different class, series, or type of securities of the same portfolio company;
- Whether the fund borrows or has the ability to borrow at the fund-level as an alternative to the financing of portfolio companies;
- The percentage of aggregate borrowings of a fund's controlled portfolio companies (CPCs) that is at a floating (rather than fixed) rate; and
- The number of CPCs owned by a fund.

If adopted, the proposed amendments would also modify existing portions of section 4 by requiring a private equity adviser to disclose (i) more detailed information about the nature of reported events of default, including the party responsible for the event of default; (ii) additional identifying information about counterparties providing bridge financing to the advisers' CPCs; and (iii) the geographical breakdown of a fund's investments based on a percentage of the fund's net asset value.

C. New Reporting Requirements for Large Liquidity Fund Advisers

The final proposed amendments to Form PF are designed to provide the SEC with a fuller picture of the short-term financing markets in which liquidity funds invest. If adopted, they would revise how large liquidity fund advisers disclose operational information and assets, as well as portfolio, financing, and investor information. The proposed changes would require large liquidity fund advisers to report substantially the same information that money market funds would be required to report on Form N-MFP, as it would be amended per the SEC's recently proposed [money market fund reforms](#).¹²

Section 3 of Form PF would be amended to require *large liquidity fund advisers* to report:

- Whether the liquidity fund tries to maintain a stable price per share (and if so, what that price is);
- Cash separately from other categories of repo collateral when reporting assets and portfolio information;
- The total gross subscriptions and gross redemptions for each month of a fund's reporting period;
- Additional identifying information about each of a fund's portfolio securities, including the name of a repo counterparty;
- Whether a creditor is based in the United States and, if so, whether it is a "U.S. depository institution";
- Whether the fund is established as a cash management vehicle for other funds or accounts managed by the adviser or its affiliates;
- Additional information about the fund's beneficial owners;
- Information about the portfolio securities that the liquidity fund sold during the reporting period; and
- The fund's weighted average maturity and weighted average life calculated with a dollar-weighted average.

II. KEY TAKEAWAYS

- If adopted, the proposed amendments to Form PF would require large hedge fund advisers and private equity advisers to file current reports within one business day of the occurrence of certain significant events, which would supplement their existing quarterly and annual reporting obligations. The new requirements are likely to substantially increase monitoring costs for applicable private fund advisers.
- The Proposal's impact would be most significant for large private equity advisers with private equity assets under management between US\$1.5 billion and US\$2.0 billion. These advisers are not currently required to complete section 4 of Form PF but would be required to do so if the Proposal were adopted. As the SEC recognized in the proposing release, the new reporting burden for an adviser in this category would be most significant for its initial report because the adviser would need to familiarize itself with the new reporting form and might need to configure its systems to efficiently gather the required information. Advisers that currently complete section 4 would also be subject to the Proposal's expanded section 4 reporting requirements.
- As support for the Proposal, the SEC cites the need for additional data points to help EXAMs staff evaluate and target for examination private fund advisers that pose a higher risk to investors. If the Proposal is adopted as proposed, private fund advisers should be aware that reporting certain items on the amended Form PF, especially the proposed current reporting items, could trigger a potential examination.
- The SEC's amendments might not be approved in their current form. The SEC will reevaluate the Proposal following the conclusion of a 30-day public comment period. While the SEC is likely to revise and clarify certain reporting requirements in response to public comments, determining whether other reporting events have occurred may ultimately require a subjective judgment best made with the assistance of outside counsel.
- The SEC is expected to release other proposed rules governing private funds later this year. SEC Chairman Gensler previewed some of these changes in his November 2021 speech to ILPA. Given that Chairman Gensler has also expressed a desire to require additional disclosure regarding private fund fees, expenses, performance metrics, side letters, and conflicts of interest, the Proposal is perhaps a precursor to other significant proposed rule amendments that target these topics.

FOOTNOTES

¹ Form PF was first adopted in the aftermath of the 2008 financial crisis as part of a series of efforts to improve financial system stability and implement Title IV of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Currently, all investment advisers registered with the SEC must file Form PF if they (i) advise one or more private funds (defined for this purpose as funds relying on registration exemptions under section 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940) and (ii) have at least US\$150 million in assets under management.

Most private fund advisers that are required to file Form PF are required to complete only section 1 of the Form, which requires advisers to provide certain basic information regarding any private funds they advise, in addition to information about their private fund assets under management and their funds' performance and use of leverage.

However, “large private fund advisers” have additional reporting obligations. Advisers having at least US\$1.5 billion in regulatory assets under management attributable to hedge funds (large hedge fund advisers), for instance, must also complete section 2 of Form PF, which requests information about advised hedge funds’ investment strategies, counterparties, and investors. “Large liquidity fund advisers” (defined as advisers managing liquidity funds and having at least US\$1 billion in combined regulatory assets under management attributable to liquidity funds and registered money market funds at the end of any month in the prior fiscal quarter) must complete section 3 of Form PF. Finally, “large private equity fund advisers” (defined as advisers having at least US\$2 billion in regulatory assets under management attributable to private equity funds as of the last day of the advisers’ most recently completed fiscal year) must complete section 4 of the Form. Sections 3 and 4 of the Form require advisers to disclose information about advised liquidity and private equity funds similar to the hedge fund information required by section 2. Large hedge fund advisers and large liquidity fund advisers file Form PF amendments quarterly, whereas all other private fund advisers subject to Form PF must file amendments annually.

² See [SEC Chairman Gary Gensler, Prepared Remarks at the Institutional Limited Partners Association Summit](#) (Nov. 10, 2021).

³ On 9 February 2022, the SEC proposed significant reforms to the private fund industry that would, among other things, require private fund advisers to: (i) distribute a quarterly statement to private fund investors; (ii) cause the private funds they advise to undergo a financial statement audit at least annually and upon liquidation; (iii) obtain a fairness opinion in connection with an adviser-led secondary transaction; and (iv) not engage in certain activities and practices that are contrary to the public interest and the protection of investors (such as charging certain fees and expenses to a private fund or its portfolio investments). See [Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews](#), Rel. No. IA-5955 (Feb. 9, 2022).

⁴ In a statement announcing his support for the amendments, Gensler suggested that modernizing Form PF is necessary to address “significant information gaps and situations where [the SEC] would benefit from additional information.” See [SEC Chairman Gary Gensler, Statement on Form PF](#) (Jan. 26, 2022). Commissioner Hester M. Peirce, the sole Republican on the panel, voted against the Proposal, arguing that the amendments are outside the scope of the SEC’s mandate. See [SEC Commissioner Hester M. Peirce, Statement on Proposed Amendments to Form PF](#) (Jan. 26, 2022). She also questioned whether the SEC’s need for the additional data is justifiable in light of the burdens the amendments would likely cause. While the Democrat-controlled SEC provides a reasonable path forward to adoption, Commissioner Peirce offers valid criticisms of the Proposal that will likely need to be addressed in any adopting release, especially to justify the increased burden for large private equity advisers that would fall within the newly proposed lower reporting threshold.

⁵ The 30-day comment period is shorter than most comment periods, which tend to be 60 days long.

⁶ See *supra* note 1.

⁷ This reporting requirement is designed to capture both a significant loss over a relatively short rolling period and a precipitous loss over an even shorter period. For example, if a fund’s most recent net asset value were US\$1 billion, the reporting requirement would be triggered if (i) the fund lost US\$20 million per business day for 10 consecutive business days, or (ii) the fund lost US\$200 million in a single business day.

⁷ The proposing release defines a “significant increase” as a cumulative increase in margin of more than 20

percent of the reporting fund's most recent net asset value over a rolling 10-business-day period.

⁹ A current report would be triggered if a counterparty to the reporting fund (1) does not meet a call for margin or has failed to make any other payment in the time and form contractually required (taking into account any contractually agreed cure period; and (ii) the amount involved is greater than 5 percent of the most recent net asset value of the reporting fund.

¹⁰ The SEC noted that such events would include material changes to the fund's ability to trade or an outright termination of the prime brokerage relationship for default or breach of the prime brokerage agreement. However, determining whether a material change has occurred requires a subjective judgment that is perhaps best made with the assistance of outside counsel.

¹¹ To report significant changes in unencumbered cash, advisers that do not do so already will also need to start calculating a daily unencumbered cash figure. To do so, they should use the same methodology that they use to calculate their answer to question 33 on the current version of Form PF.

¹² For a recent discussion of the SEC's proposed amendments to Form N-MFP, and money market funds more broadly, please see K&L Gates Alert, [SEC Proposes Another Round of Money Market Fund Reforms](#) (Dec. 17, 2021).

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