SEC and CFTC Propose Amendments to Form PF

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PRACTICES Investment Management, Fund Formation and Management, Private Equity

On August 10, the Securities and Exchange Commission ("SEC") voted 3-2 to propose amendments to Form PF that the SEC believes would enhance the Financial Stability Oversight Council's ("FSOC") ability to assess risk while also bolstering the SEC's oversight of private fund advisers. These proposed amendments were concurrently proposed by the Commodity Futures Trading Commission ("CFTC").

If adopted, the proposed new rules would, among other items:

- Require new expanded reporting requirements for large hedge funds advisers and advisers to private equity funds;
- Change the reporting requirements for large private equity fund advisers;
- Decrease the reporting threshold for large private equity advisers; and
- Require advisers to report a fund's net asset value denoted to digital assets.

These proposed amendments are designed to increase the disclosures reported to provide a better picture of the private funds industry in order for the FSOC to assess risk and administer its regulatory tools. The SEC believes that since the Form PF was adopted, the private fund industry has grown, and a variety of investments strategies have increased in usage, and therefore the Form PF needs to be amended to capture this new and relevant data. A brief overview of the proposed amendments is set forth below.

SUMMARY OF PROPOSED AMENDMENTS

Proposed Amendments to the General Instructions

The proposed amendments to the general instructions include requiring advisers to separately report each component fund that is a part of a master-feeder, except where the feeder invests all of its assets into a single master fund. The proposed amendments also include requiring advisers to separately report each component fund that is a part of a parallel fund structure while also reporting private funds that invest in other funds.

Currently, the Form PF allows advisers flexibility when reporting a master-feeder structure as long as the reporting methodology used is consistent throughout the Form PF. However, the SEC believes this approach has not provided a clear risk assessment when reviewing or comparing complex structures. Thus, it is proposed that advisers be required to report each component of a master-feeder and parallel fund structure.

Additionally, the proposed amendments include a change to Instruction 7. This change would require an adviser to include the value of a reporting fund's investments in other private funds when answering questions throughout the Form PF. This proposed change would apply to each applicable question unless directed otherwise by the instructions.

Proposed Amendments to Enhance Reporting by Large Hedge Fund Advisers on Qualifying Hedge Funds.

The changes here are focused on reported information by large hedge fund advisers found in Section 2 of the Form PF. This section of the Form PF focuses on collecting aggregate hedge fund information in Section 2a and additional information on hedge funds with a net asset value (“NAV”) of at least $500 million in Section 2b. Changes would include removing the aggregate reporting in Section 2a and expand reporting in Section 2b by requiring more detailed data on these large reported hedge funds.

The SEC believes that aggregated adviser level information combines funds with different strategies, which ends up providing the FSOC with less meaningful data. Furthermore, the SEC claims that data aggregation is burdensome on advisers and masks risks while also being inconsistent with per fund reporting in Section 2b. The SEC is seeking comments on whether Section 2a should be eliminated in its entirety, or whether some subset of Section 2a questions should remain.

The proposed changes in Section 2b are more thorough as they are proposing to:

1. Enhance and expand investment exposure reporting;
2. Revise reporting for open and large positions;
3. Revise reporting for borrowing and counterparty exposure;
4. Revise reporting for market factor effects; and
5. Make other changes that the SEC deems will streamline the value of the data collected on hedge funds by adding reporting on currency exposure, turnover, country and industry exposure, and collecting new information on investment performance.

The above changes to Section 2b would mean:

- Replacing the current Question 30 table format with narrative instructions and a drop-down menu;
- Require reporting based on “instrument type” within sub-asset classes;
- Require “adjusted exposure” to be calculated for each asset class;
- Require each sub-asset class that has interest rate risk to include uniform interest rate risk measure reporting; and
- Amend the list of reportable sub-asset classes and expand collection methods accordingly.

The proposed amendments referring to instrument type would require advisers to report the dollar value of long and short positions for sub-asset classes, such as leveraged loans. Moreover, the SEC is requesting comments on whether there should be an alternative qualifying definition of hedge fund based on the leveraging characteristics of a fund. The SEC believes that a revised definition could ensure more accurate information provided.

Proposed Amendments to Enhance Reporting on Basic Information About Private Fund Advisers and the Funds Advised.

These proposed amendments also target Section 1 of the Form PF which each adviser is required to fill out in part or completely.

The amendments to Section 1a propose to:

- Require advisers to report legal entity identifiers ("LEIs") for themselves and related funds; and
- Amend Question 3 of Section 1a to direct advisers to exclude the value of private funds' investments in other internal private funds, affecting the assets under management reported.

The proposed amendments to Section 1b are intended to provide the FSOC with greater detail into the performance and strategies of all private funds. These amendments would require advisers to report additional identifying information about the funds they manage, such as the funds' assets, financing, investor concentration, withdrawal and redemption rights, and performance. Specifically, these amendments would:

- Require the adviser to specify from a drop-down menu what kind of fund they advise;
- Require advisers to report identifying information about master-feeder arrangements; and
- Require all advisers to report whether withdrawal or redemption rights are provided to investors in the ordinary course.

Proposed Amendments Addressing Large Private Equity Advisers.

Currently, the threshold for reporting a large private equity adviser is $2 billion in private equity fund assets under management. The amendments propose to lower the threshold to $1.5 billion in private equity assets under management in order for the FSOC to receive data from a similar portion of the private equity industry as it did when the Form PF was introduced.

Proposed Amendments Addressing Digital Assets.

These proposed amendments include expanding strategy categories for advisers to choose from when reporting, which includes a new "digital assets" category. Currently, advisers may report this information in the "other" category, but the SEC believes that providing digital assets its own category will improve the quality of data collected.

Moreover, these amendments propose to require large advisers to qualifying hedge fund in Section 2b to report their total exposure to digital assets. This would require advisers to provide a good faith estimate of the percentage of the reporting fund's net asset value presented in digital assets.

CONCLUSION

If adopted, these proposed amendments would significantly increase the disclosure and reporting requirements applicable to all advisers but especially to large hedge fund advisers on qualifying hedge funds. Interested persons must submit any comments and feedback to the SEC regarding the proposed new rules on or before the later of (i) 30 days after publication of the proposed new rules in the Federal Register or (ii) October 11, 2022.

For more information or if you have any questions, please contact one of the following Haynes Boone attorneys: