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Form PF Will Result in Substantial Reporting Requirements for Registered Advisers to Private Funds

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(Summary Chart on page 5 revised April 25, 2012)

On October 26 and October 31, the U.S. Securities and Exchange Commission (SEC) and Commodity Futures Trading Commission (CFTC), respectively, approved rules that will require certain investment advisers to report extensive information to the SEC on Form PF about the private funds they advise.[1] The new reporting regime is an outgrowth of the July 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) and is designed to provide the Financial Stability Oversight Council (FSOC)—another progeny of the Dodd-Frank Act—with information that will help FSOC monitor systemic risk in the U.S. financial system. Form PF is designed to supplement Form ADV, which was also revised in June 2011 to include substantial information about private funds advised by reporting advisers. Although Form PF has been significantly streamlined from the version proffered in the Proposing Release, and has been aligned in many ways with foreign reporting requirements,[2] it will still represent an arduous and ongoing task for reporting advisers.

Who must report on Form PF? As an initial threshold, an investment adviser must file Form PF if it is registered or required to be registered with the SEC, advises one or more "private funds" (e.g., 3(c)(1) or 3(c)(7) funds), and had at least $150 million in regulatory assets under management[3] attributable to such private funds at the end of its last fiscal year. Advisers that are not registered with the SEC or are exempt from registration—such as exempt reporting advisers—are not required to file Form PF. Importantly, although the Adopting Release refers to "private fund advisers" throughout, this essentially refers to registered advisers that advise private funds and does *not* refer to so-called "private fund advisers" that are exempt from SEC registration under Section 203(m) of the Investment Advisers Act of 1940 (Advisers Act).

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1. *See* Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF, Advisers Act Rel. No. 3308 (Oct. 31, 2011), *available at* http://www.sec.gov/rules/final/2011/ia-3308.pdf (Adopting Release); *see also* Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF, Advisers Act Rel. No. 3145 (Jan. 26, 2011), *available at* http://www.sec.gov/rules/proposed/2011/ia-3145.pdf (Proposing Release).
2. The SEC and CFTC noted that their staffs consulted with the United Kingdom's Financial Services Authority, the European Securities and Markets Authority, the International Organization of Securities Commissions, and Hong Kong's Securities and Futures Commission, and the Adopting Release points out where reporting requirements were influenced by or will be similar to those imposed by these foreign regulators.
3. "Regulatory assets under management" are calculated gross of outstanding indebtedness and other accrued but unpaid liabilities.

A commodity pool operator (CPO) or commodity trading advisor (CTA) that is also registered (or required to be registered) as an investment adviser *must* also file Form PF for those commodity pools that it manages that are "private funds" and *may* file Form PF for any other managed commodity pools that are not "private funds." CPOs and CTAs that file Form PF will be deemed to meet applicable CFTC filing requirements for commodity pools, should the CFTC adopt them.

All reporting advisers must file Section 1 of Form PF (which is further described below), but certain "large" advisers to private funds are required to submit additional information on Form PF. In determining whether it meets these "large" thresholds, an adviser must aggregate with its private fund assets (i) parallel managed accounts that pursue substantially the same investment objective and strategy and invest in substantially the same positions, and (ii) private funds assets advised by related persons[4] that are not operated separately from the adviser. However, parallel managed accounts that exceed the value of the adviser's private fund assets need not be aggregated. These "large" advisers include:

- *Large Advisers to Hedge Funds.* Reporting advisers that have at least $1.5 billion in regulatory assets under management of "hedge funds" as of the end of any month during the adviser's prior fiscal quarter are required to file Sections 1 and 2 of Form PF. "Hedge funds" are defined (for the purposes of Form PF only) as private funds that (i) include a performance fee that takes into account market value (instead of being limited to realized gains), (ii) are highly leveraged, or (iii) engage in short selling. Hedge funds do not include securitized asset funds. Further, performance fees used solely for financial reporting purposes and not paid to an adviser or its related persons are not included, and short selling for hedging currency exposure or managing duration will not qualify a private fund as a "hedge fund." Large advisers to hedge funds are required to report on Form PF quarterly within 60 days of the end of each fiscal quarter.
- *Large Advisers to Liquidity Funds.* Reporting advisers that have at least $1 billion in regulatory assets under management in liquidity funds and registered money market funds (in the aggregate) as of the end of any month during the adviser's prior fiscal quarter are required to file Sections 1 and 3 of Form PF. "Liquidity funds" are defined as private funds that seek to generate income by investing in short-term obligations in order to maintain a stable net asset value or minimize principal volatility. Large advisers to liquidity funds are required to report on Form PF quarterly within 15 days of the end of each fiscal quarter.
- *Large Advisers to Private Equity Funds.* Reporting advisers that have at least $2 billion in regulatory assets under management in private equity funds as of the last day of the adviser's prior fiscal year end are required to file Sections 1 and 4 of Form PF. "Private equity funds" are private funds that are not hedge funds, liquidity funds, real estate funds, securitized asset funds, or venture capital funds (all of which are defined in Form PF) and that do not provide investors with redemption rights in the ordinary course. Large advisers to private equity funds are required to report on Form PF annually within 120 days of their fiscal year end.

Funds of Funds. In determining its reporting status and in submitting Form PF, an adviser need not include private fund assets invested in the equity of other private funds (e.g., funds of funds). Further, for private funds that hold only the equity of other private funds, cash, cash equivalents, and currency hedging instruments, an adviser need only complete Section 1(b) of Form PF with respect to such funds.

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4. Generally, an adviser's related persons are its officers, partners, directors, employees and all persons controlling, controlled by, or under common control with the adviser.

Non-U.S. Funds and Non-U.S. Advisers. An adviser may also treat any non-U.S. fund that would be a private fund if it used U.S. jurisdictional means in offering its shares as a "private fund" even though such a fund would not otherwise be a "private fund" for purposes of Form PF. Further, where a reporting adviser has its principal office and place of business outside the United States, the adviser may exclude for the purposes of Form PF those private funds that during the adviser's prior fiscal year were not U.S. persons, offered in the United States or beneficially owned by any U.S. person. Non-U.S. fund advisers that have less than $150 million or $1.5 billion of assets contributed to their hedge funds by U.S. persons may want to consider moving all U.S. persons to separate funds so that only those funds will be considered to be "private funds." Consequently, no Form PF filing would be required for such non-U.S. advisers that have less than $150 million of assets under management in their U.S.-only private funds and only the short-form filing (Section 1 only) would be required for such non-U.S. advisers with less than $1.5 billion in their U.S.-only hedge funds.

Initial Filings. For a reporting adviser's initial Form PF filing requirements, "large" advisers are split into two groups: large advisers to hedge funds or liquidity funds with at least $5 billion in assets are required to file their initial reports within 60 days and 15 days, respectively, of the end of their last quarter before June 15, 2012. Large advisers to private equity funds with $5 billion in assets are required to file their initial reports within 120 days of their first fiscal year end on or after June 15, 2012. Reporting advisers that are not "large" advisers and large advisers that have less than $5 billion of assets must file their initial reports within the applicable period after December 15, 2012. These filing requirements and the various thresholds in determining a reporting adviser's status are summarized in the chart on page 5.

Affiliates and Sub-Advisory Relationships. Advisers and their related persons are permitted to report on a single Form PF. For sub-advisory arrangements, the Adopting Release indicates that fund information should only be reported once and the adviser that reports the private fund information in response to Section 7.B.1 of Schedule D to Form ADV should be the adviser that reports on Form PF, unless such adviser is not otherwise required to file Form PF. Thus, advisers and sub-advisers will be required to coordinate reporting obligations to ensure that, between the two, private fund information is reported if required.

Required Information. The information required of each reporting adviser is substantial and will likely require advisers to, at a minimum, alter their compliance policies and procedures, but may also require advisers to recode their recordkeeping systems. As adopted, however, Form PF generally permits advisers to rely on existing systems to provide information, a key difference compared to the requirements proposed in January 2011. Notably, Form PF removed the proposed requirement that submitting officials of the adviser certify, under penalty of perjury, the information contained therein. Further, an adviser is not required to update information that was provided in good faith at the time of submitting Form PF even if such information was subsequently revised for recordkeeping, risk management, or investor reporting purposes. Given the depth and complexity of the required information, advisers, especially when submitting their initial reports, will have to carefully review Form PF and all of its instructions and definitions. Further, although reporting advisers may only have to submit Form PF to the SEC on a quarterly or annual basis, much of the required information must be gathered monthly. The information required by Form PF can be generally summarized as follows:

- *Sections 1(a), 1(b), and 1(c)—All Reporting Advisers.* Section 1 requires advisers to provide general identifying information, assets under management, size, leverage and performance information for each private fund and also basic information on hedge funds. Advisers must also provide information about related persons and their large trader identification numbers. With respect to each private fund, advisers must provide gross and net assets, derivative positions,

borrowings, concentration of equity holders, investments in private funds and parallel managed accounts, performance information (with the same frequency with which the advisers already calculate performance), beneficial ownership, assets and liabilities, investment strategies (including use of high-frequency strategies) and counterparty exposures. All of the information in Sections 1(b) and 1(c) must be provided for each private fund.

- *Sections 2(a) and 2(b)—Large Advisers to Hedge Funds.* Section 2(a) requires large advisers to hedge funds to disclose aggregate information about their hedge funds' asset values; holdings in mortgage-backed securities; CDOs, CLOs, and other structured products; duration or other measures of fixed income holdings; turnover; and geographical exposures. Section 2(b) requires large advisers to hedge funds to disclose, for each hedge fund with a net asset value of at least $500 million, fund-specific information, including asset exposures, liquidity, concentration, cash holdings, base currency, collateral practices with counterparties, use of central clearing counterparties, risk metrics, impact from market factors, borrowing and credit support, total notional derivatives exposure and mark-to-market value of uncleared derivatives positions and, in certain circumstances, side pocket and gating arrangements.
- *Section 3—Large Advisers to Liquidity Funds.* Section 3 requires large advisers to liquidity funds to provide information on portfolio valuation and valuation methodology, liquidity, whether the fund follows Rule 2a-7 under the Investment Company Act of 1940, exposure to certain instruments, and concentration of investor base.
- *Section 4—Large Advisers to Private Equity Funds.* Section 4 requires large advisers to private equity funds to provide substantial information about their underlying portfolio companies, including any guarantees of portfolio company obligations provided by the fund and leverage amounts of the portfolio companies. Advisers must also report debt-to-equity ratios and gross asset values of portfolio companies and break down the fund's investments by industry and geography.

Confidentiality of Information. Although information submitted on Form PF is nonpublic and not subject to Freedom of Information Act requests, the SEC may use the information in enforcement actions and it may be accessed by various federal departments and agencies, including FSOC and the CFTC, and by self-regulatory organizations within the scope of their jurisdiction. The SEC indicated that it is currently working on implementing substantial safeguards to protect the confidentiality of information. Form PF will be submitted electronically to a system designed and hosted by the Financial Industry Regulatory Authority (FINRA).

Implications for Advisers. Advisers subject to Form PF reporting have some time to review their structures and determine their status and subsequent reporting requirements (large advisers to liquidity funds with $5 billion in assets will make the first Form PF filings on or about June 15, 2012). Nonetheless, because of the substantial reporting requirements, advisers should begin reviewing Form PF now to ensure that their systems are appropriately designed to capture necessary information as their applicable deadline approaches.

(continued on page 6)

Summary of Form PF Qualifying Thresholds and Reporting Frequency

Form PF Classification	Registration Status^	AUM Threshold*	Date of AUM Measurement	Required Form PF Section(s)	Relevant Definition	SEC Estimate of Applicable Advisers	Frequency of Reporting	Reporting Deadline	Compliance Date	Initial Filing Date (assuming adviser has calendar fiscal year)
"Smaller" advisers to private funds	Registered (or required to be registered)	Greater than $150 million in private fund AUM, but less than a "large" threshold	End of most recently completed fiscal year	1	"Private Fund"—3(c)(1) or 3(c)(7) fund (Section 202(a)(29))	3,070	Annually	120 days after fiscal year end	December 15, 2012	April 30, 2013
"Large" advisers to hedge funds	Registered (or required to be registered)	At least $1.5 billion in hedge fund AUM	End of <u>any</u> month during prior fiscal quarter	1 and 2	"Hedge Fund"—private fund that (a) features a performance fee paid to the adviser that takes into account market value (not just realized gains), (b) is highly leveraged, <u>or</u> (c) uses short sales (beyond hedging currency exposure or managing duration)	230 U.S.-based, 23 non-U.S. based	Quarterly	60 days from end of each fiscal quarter	June 15, 2012 if adviser had $5 billion in hedge fund AUM as of the last day of prior fiscal quarter December 15, 2012 if less than $5 billion	August 29, 2012 (if $5 billion AUM on March 31, 2012) March 1, 2013 (if less than $5 billion AUM on September 30, 2012)
"Large" advisers to liquidity funds	Registered (or required to be registered)	At least $1 billion in combined liquidity fund and registered money market fund AUM	End of <u>any</u> month during prior fiscal quarter	1 and 3	"Liquidity Fund"—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	80	Quarterly	15 days from end of each fiscal quarter	June 15, 2012 if adviser had $5 billion in liquidity and registered money market funds AUM (combined) as of the last day of prior fiscal quarter December 15, 2012 if less than $5 billion	July 15, 2012 (if $5 billion AUM on March 31, 2012) January 15, 2013 (if less than $5 billion AUM on September 30, 2012)
"Large" advisers to private equity funds	Registered (or required to be registered)	At least $2 billion in private equity fund AUM	Last day of most recent fiscal year	1 and 4	"Private Equity Fund"—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	155 U.S.-based, 16 non-U.S. based	Annually	120 days after fiscal year end	June 15, 2012 if adviser had $5 billion in private equity fund AUM as of the last day of first fiscal year end on or after June 15, 2012 December 15, 2012 if less than $5 billion	April 30, 2013 (if $5 billion AUM on December 31, 2012) April 30, 2013 (if less than $5 billion AUM on December 31, 2012)

^Unregistered advisers (that are not required to be registered) and "exempt reporting advisers" relying on either Section 203(l) or 203(m) of the Advisers Act are not required to file Form PF. Advisers that are registered (or required to be registered) but do not have $150 million in private fund assets also do not have to file Form PF.

**Calculated gross of outstanding indebtedness and other accrued but unpaid liabilities. Aggregated with (i) parallel managed accounts advised "by the firm that are equal to or smaller than the private funds with which they are managed, and (ii) private fund assets advised by the firm's "related persons," unless such related persons are operationally separate.*

Foreign SEC-registered advisers with minimal U.S. assets under management may be able to reorganize those U.S. assets into an isolated fund that is offered only to U.S. investors, which could either permit such an adviser to avoid Form PF filing requirements entirely (if it has less than $150 million of U.S. assets under management), or minimize the filing burden by only requiring the adviser to file Section 1 of Form PF (if it has between $150 million and $1.5 billion in U.S. assets under management in hedge funds, between $150 million and $1 billion in U.S. assets under management in liquidity and registered money market funds, or between $150 million and $2 billion in U.S. assets under management in private equity funds).

Advisers that qualify as "family offices" under Section 202(a)(11)(G) and the recently adopted Rule 202(a)(11)(G)-1—and that are therefore excluded from the definition of "investment adviser"—also do not have any obligations with respect to Form PF, which could motivate advisers to restructure to qualify for the Section 202(a)(11)(G) exception or for other Section 202(a)(11) exceptions in order to avoid Form PF filing obligations.

Although information reported on Form PF shall be kept confidential, it is subject to review by various government agencies, which, despite the implementation of appropriate safeguards, increases the risk that such information could be leaked and become public. Advisers that will be reporting on Form PF on or after the compliance date should, in the interim, review their systems to determine whether steps could be taken to further protect the proprietary nature of the information that will be reported.

Additional Guidance. Morgan Lewis will continue to monitor this and other financial industry regulatory developments and is well positioned to advise investment advisers, CPOs, and CTAs on the implications of Form PF and how to interpret the various requirements under the new reporting regime.

If you would like more information or have any questions about the issues discussed in this LawFlash, please contact any of the following Morgan Lewis attorneys:

Miami

Ethan W. Johnson	305.415.3394	ejohnson@morganlewis.com

New York

P. Georgia Bullitt	212.309.6683	gbullitt@morganlewis.com
Jennifer L. Klass	212.309.7105	jklass@morganlewis.com
Louis H. Singer	212.309.6603	lsinger@morganlewis.com
Jedd H. Wider	212.309.6605	jwider@morganlewis.com

Philadelphia

Timothy W. Levin	215.963.5037	tlevin@morganlewis.com
John J. O'Brien	215.963.4969	jobrien@morganlewis.com

Washington, D.C.

Thomas S. Harman	202.739.5662	tharman@morganlewis.com
Monica Lea Parry	202.739.5692	mparry@morganlewis.com
Steven W. Stone	202.739.5453	sstone@morganlewis.com
Laura E. Flores	202.739.5684	lflores@morganlewis.com

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