

SEC and CFTC Propose Reporting Requirements for Investment Advisers to Private Funds

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The Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC) issued rule proposals requiring investment advisers to private funds, which are not regulated by these two agencies, to provide detailed and comprehensive financial, portfolio, and operational information. The amount and nature of the required information is substantially more than is required to be provided by those funds and companies that the SEC and the CFTC do regulate. Although the proposal's requirements are significant to private funds and their advisers, they are also noteworthy for registered funds, traditional money managers, and public companies as a possible indicator of requirements to come. The entire financial services community will be closely monitoring these developments as they unfold.

BACKGROUND

On January 26, the SEC and the CFTC proposed joint new rules under the Investment Advisers Act of 1940 (Advisers Act) and the Commodity Exchange Act (CEA) to implement Sections 404 and 406 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act).¹ The proposed rules, if adopted, will require investment advisers registered with the SEC that advise one or more private funds to file with the SEC, on a confidential basis, through Form PF. The form must be filed quarterly by larger private fund advisers and annually by smaller private fund advisers.² The CFTC has separately proposed that commodity pool operators and commodity trading advisers file similar information on Form CPO-PQR and Form CTA-PR, respectively.

Section 404 of the Dodd-Frank Act directs the SEC to require private fund advisers to maintain records and file reports containing such information as necessary or investor protection or the assessment of systemic risk. Section 406 requires that the SEC and the CFTC jointly issue rules, after consultation with the Financial Stability Oversight Council (FSOC), establishing the form and content of reports required to be filed by investment advisers registered with both commissions.

1. See Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF, CEA Release No. 3038, Advisers Act Release No. 3145 (Jan. 26, 2011) (Proposing Release), available at <http://www.sec.gov/rules/proposed/2011/ia-3145.pdf>.

2. The requirement to file a Form PF does not replace the reporting requirements for Form ADV.

The commissions indicated that Form PF has two principal purposes. First, the information collected through Form PF will be provided to the FSOC to monitor the systemic risks that private funds may pose to the U.S. financial system. Second, the information is intended to enhance the ability of the commissions to evaluate regulatory policies and improve the efficiency and effectiveness of the monitoring of markets for investor protection and market vitality. Although not mentioned as a purpose underlying the filings, the commissions clearly reserve the right to use information included in the filings as evidence in connection with enforcement actions against the registered advisers.

ELEMENTS OF THE PROPOSAL

Private Fund Definition

A “private fund” is defined in the proposal as a fund that would be an investment company if not for Section 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940.

Private Fund Advisers Required to File Form PF

Under the proposed rules, all private fund advisers registered with the SEC must file Form PF. The amount of information that a private fund adviser must provide, however, is determined by the adviser’s assets under management (AUM).

Small Private Fund Advisers. Private fund advisers registered with the SEC managing less than \$1 billion in private fund assets would be required to file Section 1 of Form PF, providing certain basic identifying information regarding any private funds they advise (as discussed below). Advisers that are either solely advisers to venture capital funds or are solely advisers to private funds that in the aggregate have less than \$150 million in assets under management in the United States are exempt from registering with the SEC and thus are not required to file Form PF. Private fund advisers that manage less than \$150 million in private fund assets will be required to file Section 1 of Form PF if they are otherwise required to register with the SEC (for example, if they have a single client that is not a private fund and therefore do not qualify for the exemption from registration with the SEC).

Large Private Fund Advisers. Large private fund advisers, which are advisers with AUM equal to or exceeding \$1 billion,³ must also complete and file Section 1 of Form PF. Further, depending on the type of private funds they advise, they must file additional sections of the form, including information about hedge funds (Section 2), liquidity funds (Section 3), and private equity funds (Section 4).⁴

Hedge Funds. Under the proposed rules, a private fund would meet the definition of a “hedge fund” if it satisfies any **one** of the following three definitions: (1) a private fund that has a performance fee or allocation calculated by taking into account unrealized gains, (2) a private fund that is authorized to borrow an amount in excess of one-half of its net asset value (including any committed capital) or may

3. In determining whether it is considered a large private fund adviser under the proposal, an adviser is required to aggregate (i) assets of managed accounts advised by the firm that pursue substantially the same investment objective and strategy and invest in substantially the same positions as the private fund and (ii) assets of that type of private fund advised by any of the adviser’s related persons. According to the proposing release, these proposed aggregation requirements are designed to prevent an adviser from avoiding the proposed reporting requirements by restructuring the manner of providing private fund advice internally within the private fund manager group.

4. If an adviser’s principal office and place of business is outside the United States, the adviser could exclude any private fund that during the last fiscal year was neither a U.S. person nor was offered to or beneficially owned by any U.S. person.

have gross notional exposure in excess of twice its net asset value (including any committed capital), or (3) a private fund that is authorized to sell securities or other assets short.⁵

Liquidity Funds. A liquidity fund is defined under the proposal 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.⁶

Private Equity Funds. For purposes of Form PF, a 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.

Information to Be Provided Under Form PF

The proposed form is 44 pages long and requires that a signatory on behalf of the adviser as well as each related person (e.g., an affiliated adviser) who is filing in tandem with the adviser, under penalty of perjury, certify that the information in the form is true and correct. The signers must acknowledge that any false or misleading statement of a material fact or material omission is a violation of the CEA. The lead into the form expressly notes that “[f]alse statements or omissions may result in revocation of your registration or criminal prosecution.”

Section 1 – Capital Structure, Strategy, Performance, Creditor Information, and Trading and Clearing Exposures

Section 1 requires private fund advisers to provide information regarding (i) capital structure, (ii) leverage, (iii) performance, (iv) strategy, (v) trading and clearing relationships, and (vi) trading and clearing volume by investment type. Detailed questions apply to creditor and counterparty exposure. For example, the form requires a listing of the five largest trading counterparties, across all asset classes, to which the reporting fund has the greatest net counterparty credit exposure, measured as a percentage of net asset value. Similarly, the form requires the fund to categorize creditors by type and to give percentage of total borrowings made from (i) U.S. financial institutions, (ii) non-U.S. financial institutions, and (iii) nonfinancial institutions.

Section 2 – Portfolio Information and Investor Liquidity

Section 2 applies to all large private fund advisers advising hedge funds and requires detailed portfolio information, including information regarding concentrated positions, counterparty exposures, including itemizations of collateral posted to the fund by each of the top five trading counterparties, Value-at-Risk (VaR)-based risk metrics, and a detailed discussion of financing arrangements. This section also requires information about liquidity restrictions and side-pocket arrangements.

5. For purposes of determining whether a private fund is a qualifying hedge fund, the adviser would have to aggregate any parallel managed accounts, parallel funds, and funds that are part of the same master-feeder agreement, and would have to treat any private funds managed by its related person as if they were managed by the filing adviser.

6. A liquidity fund would seem to include investment pools used by stock lending agents and similar vehicles.

Section 3 – Liquidity Funds

Section 3 would apply to all large private fund advisers advising liquidity funds. This section includes detailed performance and portfolio information as well as information regarding financing arrangements and investor liquidity.

Section 4 – Private Equity Funds

Section 4 would apply to large private fund advisers advising private equity funds. Like the liquidity fund section, the form asks for detailed information regarding holdings and financing arrangements. It also focuses on information regarding foreign investments, broken down by country and region. The disclosure includes information regarding investments by the adviser and its related persons in portfolio companies of the fund.

In addition to the information required in the proposed form, FSOC may, if it deems necessary, direct the Office of Financial Research to collect additional information regarding the funds from time to time.

Frequency of Reporting

The proposed rules would require private fund advisers to file a Form PF on an annual basis, no later than the last day on which the adviser may timely file its annual updating amendment to Form ADV (currently, 90 days after the end of the adviser's fiscal year), except that large private fund advisers would have to file a Form PF no later than 15 days after the end of each calendar quarter. A newly registered adviser's Form PF filing would be required to be submitted within 15 days of the end of its next occurring calendar quarter after registering with the SEC.

Filing Fees and Format

Under the proposed rules, private fund advisers would file Form PF through an electronic filing system that is expected to be operated by an entity designated by the SEC. The filings will be subject to filing fees.

Filings are made on a confidential basis and are exempt from disclosure pursuant to the Freedom of Information Act. Filings, however, are intended to be shared with other regulators.

The commissions make clear that any failure to file or update Form PF in the time and manner required is a violation of the commissions' rules. It is very likely there may be fees or possibly even other disciplinary actions resulting from late filings.

Compliance Dates

The SEC and the CFTC anticipate that the proposed rules will have a compliance date of December 15, 2011. Large private fund advisers would need to make their initial Form PF filing by January 15, 2012, while smaller private fund advisers with a December 31 fiscal year-end would need to file their first Form PF by March 31, 2012.

Proposed Forms CPO-PQR and CTA-PR

In a separate release, the CFTC proposed rules that would require commodity pool operators (CPOs) to file proposed Form CPO-PQR and commodity trading advisors (CTAs) to file proposed Form CTA-PR requesting information that is generally similar to that information requested in Form PF.⁷ As part of the joint release, the CFTC proposed that private fund advisers that are dually registered with the SEC and the CFTC would satisfy certain of the proposed CFTC filing requirements by filing Form PF with the SEC. Irrespective of their filing a Form PF with the SEC, however, all private fund advisers that are also registered as CPOs and CTAs with the CFTC would be required to file Schedule A of proposed Form CPO-PQR and CTA-PR, as applicable. Additionally, CPOs and CTAs, depending on their size and that of the funds they operate or advise, will be required to file certain sections of proposed Form CPO-PQR and CTA-PR, as applicable, for any fund that is not a private fund.

Request for Comments

The commissions have requested comments on the rule proposal and Form PF. The CFTC has also requested comments on Forms CPO-PQR and CTA-PR. The deadline for comments will be 60 days after the proposed rules are published in the *Federal Register*.

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

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7. See Commodity Pool Operators and Commodity Trading Advisers: Amendments to Compliance Obligations, CFTC Release No. 3038 (Jan. 26, 2011), available at <http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister012611b.pdf>.

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