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SEC, CFTC Jointly Demand More Hedge-Fund Disclosures

By **Tom Zanki**

Law360 (February 8, 2024, 9:39 PM EST) -- The U.S. Securities and Exchange Commission and U.S. Commodity Futures Trading Commission jointly passed rules Thursday requiring additional disclosures from hedge funds and other private fund advisers, aimed at improving market stability and transparency, despite dissent from Republican commissioners of both agencies who say the requirements are overreaching.

The rules would amend Form PF, a quarterly disclosure created in 2011 as part of the Dodd-Frank legislation's push to curb industry abuses following the financial crisis.

Such disclosures, which are confidentially provided to regulators, will apply to SEC-registered fund advisers reporting on qualifying hedge funds with assets of at least $500 million. The new disclosure rules will also apply to certain funds registered with the CFTC as a commodity pool operator or commodity trading adviser.

Since the enactment of Form PF 13 years ago, SEC Chair Gary Gensler said securities and commodities regulators have discovered gaps in the information that agencies collect from private fund advisers. Both agencies proposed requiring additional Form PF disclosures in August 2022, agreeing that they would share pertinent information.

Gensler said final rules would improve the ability of both agencies and the Financial Stability Oversight Council — a body created by the Dodd-Frank Act to oversee market stability — to assess threats to the financial system. He noted that private funds have tripled in size over the last decade to about $26 trillion in assets, compared with $23 trillion in assets managed by commercial banks.

"This makes visibility into these funds critical," Gensler said.

The new rules will require advisers of large hedge funds to disclose more information about their operations and strategies and provide more details about their investments, including country and industry exposure, borrowing and counterparty exposure, currency exposure, central clearing counterparty reporting, liquidity, and other metrics.

The rules also mandate additional information regarding complex structures deployed by hedge funds. As a result, both agencies and the FSOC will have more insight into things like master-feeder arrangements, or structures whereby hedge funds combine investments from domestic and overseas investors into one master fund.

Republican commissioners on both agencies opposed the rules, arguing that regulators are peering into private funds' operations beyond necessity. The 375-page rule passed both agencies by a 3-2 vote, drawing dissent from SEC commissioners Hester Peirce and Mark Uyeda and CFTC commissioners Caroline Pham and Summer Mersinger.

"In our never-satisfied hunger for more particularized information, we too casually ignore concerns about cost, utility, and data protection," Peirce said in a statement. "Form PF contains highly proprietary information. Unless we need it, we should not collect it. The leakage of such confidential business information could have serious competitive repercussions."

Thursday's joint action marks the third time that the SEC has expanded Form PF information requirements. The securities' watchdog in May 2023 increased Form PF disclosures and — later in July 2023 — the SEC required large liquidity fund advisers to align their Form PF reporting requirements with those of money market funds.

Commissioners Uyeda and Pham issued a joint statement after Thursday's votes arguing that an SEC-CFTC memorandum of understanding explaining how both agencies will share information exceeds the jurisdiction of the CFTC, which regulates financial derivatives and other products.

"Providing Form PF data on SEC-only registrants ignores basic data protection principles," Uyeda and Pham said. "We are unclear as to why the CFTC needs access to all Form PF data to accomplish its mission."

Market participants were divided on the SEC-CFTC rules, depending on their perspective. Investor group Better Markets said the rules were sensible given the massive growth of private funds since 2011.

"These private funds are deeply interconnected with our financial system, which means that distress at private funds will not be limited to the funds themselves but will impact the markets and the economy as a whole, potentially triggering a full-blown crisis with devastating consequences for all Americans," Better Markets director of securities policy Benjamin Schiffrin said in a statement.

Industry group the Managed Funds Association, which represents hedge funds, called the rules misguided and predicted they will "harm regulators' ability to monitor systemic risk."

"The final rule requires advisers to submit misleading information to regulators that creates a warped perception of fund activity," MFA CEO Bryan Corbett said in a statement. "The broad, undisciplined request for data will put sensitive proprietary investment strategies at risk, drive industry consolidation, and increase the cost of investing for the beneficiaries of alternative asset managers, including pensions, foundations, and endowments."

Lawyers were also parsing the latest rules on Thursday.

Morgan Lewis & Bockius LLP partner Christine Ayako Schleppegrell, a former branch chief SEC's Division of Investment Management, said the latest amendments will require hedge fund managers to report their strategies with more granularity — including strategies involving digital assets.

Ayako Schleppegrell pointed out the rules overall will extend to private fund advisers beyond hedge funds and should be viewed in context with previous requirements.

"It's important to think about how the amendments (and the transparency they afford the SEC) interplay with other recently finalized SEC rules such as the private fund adviser rules," Ayako Schleppegrell added.

The final rules will become effective one year after publication in the Federal Register.

--Editing by Kelly Duncan.
