



Private Fund Reporting (Form PF) SEC and CFTC – Final Rule

Executive Summary

The Securities and Exchange Commission (“SEC”) has issued a final rule, Rule 204(b)-1 under the *Investment Advisers Act of 1940* (“Advisers Act”), that requires investment advisers registered or required to be registered with the SEC who advise one or more private funds and have at least \$150 million in private fund assets under management (“AUM”) to file new Form PF with the SEC. The information provided on Form PF is intended, among other things, to assist the Financial Stability Oversight Council (“Council”) in its assessment of systemic risk in the U.S. financial system.

The final rule is issued jointly with the Commodity Futures Trading Commission (“CFTC”) and also creates a new Rule 4.27 under the *Commodity Exchange Act* (“CEA”) that permits commodity pool operators (“CPOs”) and commodity trading advisors (“CTAs”) registered with the CFTC to satisfy certain CFTC systemic risk filing requirements with respect to private funds, should the CFTC adopt such requirements, by filing Form PF with the SEC, but only if those CPOs and CTAs are also registered with the SEC as investment advisers and are required to file Form PF.

The final rule becomes effective March 31, 2012 though Form PF filing requirements will vary based on the size of an investment adviser’s AUM as well as the types of private funds it manages. In general:

- Advisers to hedge funds and liquidity funds with at least \$1.5 billion and \$1 billion in AUM, respectively, will be required to file Form PF on a quarterly basis. All other advisers will be required to file Form PF on an annual basis.
- Advisers to hedge funds, liquidity funds or private equity funds with at least \$5 billion in AUM will be required to comply with the Form PF filing requirements beginning June 15, 2012. All other advisers must comply with Form PF filing requirements beginning December 15, 2012.

Background

Sections 404 and 406 of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (the “Dodd-Fran Act”) require the SEC and the CFTC to jointly adopt rules requiring investment advisers to private funds to file reports to be used by the Council to assess systemic risk. The SEC and CFTC released a proposed rule in January 2011 to implement this reporting requirement through the new Form PF. The SEC and CFTC indicate that the design of Form PF “is not intended to reflect a determination as to where systemic risk exists but rather to provide empirical data to [the Council] with which it may make a determination about the extent to which the activities of private funds or their advisers pose such risk.”

The Dodd-Frank Act also requires the Council to coordinate with foreign financial regulators in assessing systemic risk. The SEC and CFTC have consulted with a number of international groups to better align the Form PF with international approaches to private fund reporting.

Description

Scope

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;” and
- Had \$150 million or more in regulatory AUM attributable to “private funds” at the end of the most recent fiscal year.

A CPO or CTA that is also registered or required to register with the SEC as an investment adviser and satisfies the other conditions described above must file Form PF with respect to any commodity pool it manages that is a “private fund” and may file Form PF with respect to any commodity pool it manages that is not a “private fund.”

All advisers of private funds will be required to provide information about the private funds they advise, their AUM and their funds’ use of leverage. “Large Private Fund Advisers” would be required to provide additional information on Form PF by completing additional sections of the new form. These “Large Private Fund Advisers” include any adviser:

- Having at least \$1.5 billion in regulatory AUM attributable to hedge funds as of the end of any month in the prior fiscal quarter (“Large Hedge Fund Adviser”);
- Managing a liquidity fund and having at least \$1 billion in combined regulatory AUM attributable to liquidity funds and registered money market funds as of the end of any month in the prior fiscal quarter (“Large Liquidity Fund Adviser”); or
- Having at least \$2 billion in regulatory AUM attributable to private equity funds as of the last day of the adviser’s most recently completed fiscal year.

To determine if an investment adviser meets the \$150 million minimum reporting threshold or the Large Private Fund Adviser thresholds, the adviser must aggregate:

- 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 private funds advised by the firm (“parallel managed accounts”) unless the value of those accounts exceeds the value of the private funds with which they are managed; and
- Assets of private funds advised by any of the adviser’s “related persons” other than related persons that are separately operated.

For purposes of both the reporting thresholds and responding to questions on Form PF, an adviser may exclude any assets invested in the equity of other private funds. If an adviser’s principal office and place of business is outside the United States, the adviser may exclude any private fund that, during the adviser’s last fiscal year, was not a United States person, was not offered in the United States, and was not beneficially owned by any United States person.

Definitions

For purposes of Form PF, the following definitions, among others, apply.

A “hedge fund” is generally defined to include any private fund having any one of three common characteristics of a hedge fund: (1) a performance fee that takes into account market value (instead of only realized gains); (2) high leverage; or (3) short selling. For purposes of Form PF, a CPO that is reported or required to be reported on Form PF is treated as a hedge fund. (In most cases, an adviser must conclude that a fund is not a hedge fund in order to classify it as one of the other types of private funds defined in Form PF – liquidity fund, real estate fund, securitized asset fund, venture capital fund, or other private fund).

A “liquidity fund” is 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. An adviser managing liquidity funds must combine liquidity fund and registered money market fund assets for purposes of determining whether it meets the threshold for a large liquidity fund. However, it need only report the unregistered liquidity funds on 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.

“Regulatory AUM” is defined as “assets under management *gross* of outstanding indebtedness and other accrued but unpaid liabilities.” It is consistent with the SEC’s definition for purposes of Form ADV.

Form PF

Form PF is comprised of four sections, which are discussed in more detail below.

- Section 1 - to be completed by all private fund advisers;
- Section 2 - to be completed by Large Hedge Fund Advisers;
- Section 3 - to be completed by Large Liquidity Fund Advisers; and
- Section 4 - to be completed by Large Private Equity Fund Advisers.

Section 1

All private fund advisers must complete Section 1 of the Form PF and, among other things, report information for each private fund they advise, including gross and net assets, the aggregate notional value of derivative positions, borrowings, investor concentration and performance on both a gross basis and net of management fees and incentive fees and allocations. The performance information must be consistent with the performance results reported to investors. In addition, the adviser must report the value of each fund’s investments in other private funds and of the parallel managed accounts managed alongside the fund.

Advisers that manage hedge funds are required to provide information about each fund’s investment strategies, percentage of assets managed using high-frequency trading strategies, trading and clearing practices, and activities conducted outside of the securities and derivatives markets.

Section 2

All private fund advisers that have more than \$1.5 billion in hedge fund AUM at the end of any month in the previous quarter must complete Section 2 of the Form PF.

These Large Hedge Fund Advisers are required to report, on an aggregate basis, the value of assets invested (on a short and long basis) in different types of securities and commodities (e.g., different types of equities, fixed income securities, derivatives, and structured products), geographic breakdown, portfolio turnover in certain assets classes (including listed equities, corporate bonds, sovereign bonds and futures) and the duration, weighted average tenor or 10-year bond equivalent of fixed income portfolio holdings (including asset backed securities).

Additional information is required to be reported for any hedge fund that is managed by the adviser that has a net asset value of at least \$500 million as of the end of any month in the prior fiscal quarter (a "Qualifying Hedge Fund"). The additional information includes the same information reported on an aggregate basis, as well as, information regarding the Qualifying Hedge Fund's portfolio liquidity, holdings of unencumbered cash, concentration of positions, collateral practices with counterparties, trades cleared directly through a central clearing counterparty, value at risk metrics (if calculated regularly) or other risk metrics, impact from certain identified market factors, financing, derivatives exposure, investor composition and liquidity, and restrictions on investor withdrawals and redemptions.

Section 3

All private fund advisers that have more than \$1.0 billion in combined liquidity fund and registered money market fund AUM as of the end of any month in the prior fiscal quarter must complete Section 3 of the Form PF. These Large Liquidity Fund Advisers must report certain information for each liquidity fund they manage, including: portfolio valuation and valuation methodology, liquidity, investments in different types of assets, borrowings, concentration of the investor base and liquidity of ownership interests. This section also requires information regarding whether the fund, as a matter of policy, is managed in compliance with certain provisions of Rule 2a-7 under the *Investment Company Act*.

Section 4

All private fund advisers that have at least \$2 billion in private equity fund AUM at the end of their most recently completed fiscal year must complete Section 4 of the Form PF. These Large Private Equity Fund Advisers must report for each private equity fund they manage information including: guarantees of portfolio company obligations, the leverage of the portfolio companies, the weighted average debt-to-equity ratio of controlled portfolio companies, the aggregate gross asset value of controlled portfolio companies, the borrowings of controlled portfolio companies, and a breakdown by industry and geography, and identification of any controlled portfolio company that is a financial institution.

Filing Requirements

Different filing periods for Form PF are available to investment advisers based on the types of assets they manage:

- Private equity fund advisers and Large Private Equity Fund Advisers must file Form PF within 120 days of the end of each fiscal year;
- Large Hedge Fund Advisers must file Form PF within 60 days after each fiscal quarter end; and
- Large Liquidity Fund Advisers must file Form PF within 15 days after each fiscal quarter end.

Advisers are not required to file Form PF with respect to any period that ended prior to the effective date of their registrations.

An adviser that it is transitioning to only filing Form PF annually or that no longer meets the requirements for filing Form PF must file a Form PF with the Commissions no later than the last day on which the adviser's next Form PF update would be timely.

Compliance

Under the final rule, the effective date for SEC Rule 204(b)-1 under the Advisers Act, Rule 4.27 under the CEA, and new Form PF is March 31, 2012.

Compliance with the filing requirements under the final rule will occur in two stages where the largest advisers will be required to file first. In particular the effective date is:

- June 15, 2012 for advisers that:
 - Have at least \$5 billion in AUM attributable to hedge funds as of the last day of the fiscal quarter most recently completed prior to June 15, 2012;
 - Manage a liquidity fund and have at least \$5 billion in combined AUM attributable to liquidity funds and registered money market funds as of the last day of the fiscal quarter most recently completed prior to June 15, 2012; or
 - Have at least \$5 billion in AUM attributable to private equity funds as of the last day of the fiscal year ending on or after June 15, 2012.

For advisers meeting these \$5 billion thresholds, the initial Form PF filing dates will be, respectively:

- Within 60 days of June 30, 2012 (hedge fund advisers)
 - Within 15 days of June 30, 2012 (liquidity fund advisers)
 - Within 120 days of the first fiscal year ending on or after June 15, 2012 (private equity fund advisers).
- December 15, 2012 for all other advisers.

For these advisers, the initial Form PF will be required to be filed as follows:

- Within 60 days of the first fiscal quarter end after December 15, 2012 (hedge fund advisers with regulatory AUM between \$1.5 billion and less than \$5 billion);
- Within 15 days of the first fiscal quarter end after December 15, 2012 (liquidity fund advisers with regulatory AUM between \$1.billion and less than \$5 billion); and
- Within 120 days of the first fiscal year ending on or after December 15, 2012 (all other advisers to private funds).

Confidentiality

The information provided on Form PF is intended to be confidential, though the SEC indicates that it may use Form PF information for enforcement purposes. The Dodd-Frank Act amends the Advisers Act to preclude the SEC from being compelled to reveal the information except in very limited circumstances, and similarly exempts the CFTC from being compelled to disclose through the *Freedom of Information Act* any information collected through Form PF. The CFTC is also required to maintain a level

of confidentiality consistent with the requirements of the SEC's Rule 204(b).

The SEC states that it is working to design controls and systems for the use and handling of the Form PF data that reflect the sensitivity of the reported information. These efforts include the programming for the Form PF filing system to ensure there are appropriate and sufficient confidentiality protections. Depending on the progress toward development and deployment of the systems and controls, the SEC will consider whether to delay the compliance date for the filing of Form PF nearer to the effective compliance dates.

Commentary

While the Final Rule 204(b)-1 and Form PF give advisors to private funds much to be happy with as compared to the version originally proposed in January 2011, SEC registered investment advisors to private funds should not underestimate the amount of time necessary to comply with the newly adopted rule.

Identifying which of an investment advisor's funds and parallel products may be subject to Form PF reporting is an extremely time consuming process that will, despite extensions of filing deadlines, require substantial amounts of preparation well in advance of a first filing. Determining the availability of reportable information, and identifying sources for currently unavailable data will only serve to make preparations for Form PF compliance far more complex than many firms realize and one that may involve substantial costs to build an ongoing reporting mechanism.

Finally, despite removal of a previously proposed requirement to certify as to the accuracy of a Form PF's contents under penalty of perjury, firms must nevertheless consider the need for comprehensive internal certification processes to ensure that data reported on the Form PF is fully accurate.

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