

Client Alert

November 2011

SEC Adopts Rules For Private Fund Reporting

SEC Implementation of the Dodd-Frank Wall Street Reform Act

On October 26, 2011, the Securities and Exchange Commission (“SEC”) adopted new rules under the Investment Advisers Act of 1940, as amended (the “Advisers Act”), as required by Sections 404 and 406 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”). The new rules create a new reporting form — Form PF — to be filed quarterly or annually by registered investment advisers that manage private funds, including hedge funds and private equity funds. A copy of the SEC’s adopting release is available [here](#).

Background

Dodd-Frank established the Financial Stability Oversight Council (“FSOC”) for the purpose of monitoring risks to the stability of the U.S. financial system. Section 404 of Dodd-Frank requires the SEC to require private fund advisers to maintain records and file reports containing such information as the SEC deems necessary and appropriate in the public interest and for investor protection or for the assessment of systemic risk by the FSOC. Section 406 of Dodd-Frank requires the SEC, jointly with the Commodity Futures Trading Commission (“CFTC”) and after consultation with the FSOC, to issue rules establishing the form and content of such reports with respect to private fund advisers.

On January 26, 2011, the SEC and CFTC jointly proposed rules and a new reporting form to address these private fund systemic risk reporting requirements under Dodd-Frank. The new rule and new Form PF were adopted by the SEC after consideration of comments submitted by interested parties and collaboration with the CFTC and the FSOC.

The CFTC also adopted new rules that would require commodity pool operators (“CPOs”) and commodity trading advisors (“CTAs”) registered with the CFTC to satisfy certain CFTC filing requirements by filing Form PF with the SEC if they are also registered investment advisers and advise one or more private funds.

Proposed Reporting Requirements

Who must file?

Under new Rule 204(b)-1, any investment adviser registered or required to be registered with the SEC that advises one or more private funds with at least \$150 million in regulatory assets under management as of the end of its most recently completed fiscal year must file a Form PF with the SEC. The SEC added the minimum reporting threshold in response to comments received on the proposal rule. In addition, under the CFTC’s rules, private fund advisers that are also registered CPOs or CTAs with the CFTC must file Form PF to satisfy certain proposed CFTC systemic risk reporting requirements.

“Large private fund advisers” will be required to file more information and smaller advisers required to file less comprehensive information.

Large private fund advisers include:

- any adviser with at least \$1.5 billion in hedge fund regulatory (or gross) assets under management as of the end of any month during the prior fiscal quarter; or
- any adviser that advises one or more “liquidity funds” and had at least \$1 billion in combined money market and liquidity fund regulatory (or gross) assets under management as of the end of any month during the prior fiscal quarter; or
- any adviser with at least \$2 billion in private equity fund regulatory (or gross) assets under management as of the last day of the most recently completed fiscal year.

All other private fund advisers will be regarded as smaller private fund advisers.

Form PF defines “hedge fund” as any private fund that: (1) has a performance fee or allocation paid to the investment adviser that is calculated by taking into account unrealized gains; (2) may borrow any amount in excess of one-half of its net asset value (including any committed capital) or may have gross notional exposure in excess of twice its net asset value (including committed capital); or (3) may sell securities or other assets short (other than for hedging currency exposure or managing duration).

“Liquidity fund” is defined 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. The SEC’s proposed definition is intended to capture all potential substitutes for money market funds, which the SEC believes may pose systemic risk that the FSOC will want to monitor.

“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.

Securitized asset funds (any private fund whose primary purpose is to issue asset backed securities and whose investors are primarily debt-holders) are excluded from the definitions of hedge fund and private equity fund and thus advisers to such funds are considered smaller private fund advisers for purposes of Form PF irrespective of their assets under management. Real estate fund advisers also will be considered smaller private fund advisers.

Advisers must include assets of certain parallel managed accounts and related persons’ private funds in calculating whether the dollar thresholds have been met. Certain fund of fund investments may be excluded.

Exempt reporting advisers, such as advisers to venture capital funds, and other advisers not required to register with the SEC are not required to file Form PF.

When are Form PF filings due?

Smaller private fund advisers and large private equity fund advisers file Form PF once annually within 120 days after the end of the adviser’s fiscal year. Large private fund advisers (other than large private equity fund advisers) must file Form PF on a quarterly basis. Large hedge fund advisers must file within 60 days after the end of each fiscal quarter. Large liquidity fund advisers must file within 15 days after the end of each fiscal quarter.

The compliance dates for the first filings of Form PF will be phased in:

- The compliance date will be June 15, 2012, for:
 - Large hedge fund advisers with at least \$5 billion in assets under management as of the last day of the fiscal quarter prior to June 15, 2012.
 - Large liquidity fund advisers with at least \$5 billion in assets under management as of the last day of the fiscal quarter prior to June 15, 2012.
 - Large private equity fund advisers with at least \$5 billion in assets under management as of the last day of the fiscal year to end on or after June 15, 2012.
- The compliance date for all other advisers is December 15, 2012.

As a result, an adviser with \$5 billion in hedge fund assets under management as of March 31, 2012, will file its first Form PF within 60 days after June 30, 2012 (or by August 29, 2012). An adviser with \$1 billion in private equity fund assets as of the end of its December 31, 2012, fiscal year will file its first Form PF within 120 days after December 31, 2012 (or by April 30, 2013).

What information must be provided in Form PF?

Smaller private fund advisers will be required to report only basic information regarding the private funds they advise, including information regarding size, leverage, investor types and concentration, liquidity and fund performance. Smaller advisers managing hedge funds would also report information about fund strategy, counterparty credit risk and use of trading and clearing mechanisms.

Large private fund advisers will be required to provide additional information, including:

- Large private fund advisers to hedge funds must report on an aggregated basis information regarding exposures by asset class, geographical concentration and turnover by asset class. In addition, for each “qualifying hedge fund” (any hedge fund having a net asset value of at least \$500 million), large private fund advisers also must report very detailed information relating to that fund’s exposures, leverage, risk profile and liquidity (but not position level information).
- Large private fund advisers to liquidity funds must provide information on the types of assets in each liquidity fund portfolio, certain information relevant to the risk profile of the fund and the extent to which the fund has a policy of complying with all of or aspects of Rule 2a-7, the Investment Company Act of 1940’s principal rule concerning registered money market funds.
- Large private fund advisers to private equity funds must provide information on the extent of leverage incurred by their funds’ portfolio companies, the use of bridge financing and their funds’ investments in financial institutions.

Form PF requires this information to be reported largely in a “check the box” format rather than through narrative disclosure. A copy of [Form PF](#) is available with the SEC’s release.

Each private fund adviser must file one Form PF, but the information must be reported separately for each fund managed by the adviser, except that to prevent duplication, information may be provided on an aggregate basis for funds that are part of a master-feeder structure and for parallel managed accounts.

Parallel funds generally must be reported separately. Only limited information must be disclosed regarding a fund of funds.

Confidentiality of Information

Information obtained by the SEC through Form PF filings will be shared with the FSOC for the purposes of assessing the systemic risk posed by private funds. Section 404 of Dodd-Frank generally provides that the SEC and FSOC shall maintain the confidentiality of the Form PF data and that the SEC shall not be compelled to disclose any report or information contained therein except in limited circumstances. For example, the SEC may not withhold information from Congress, nor will the SEC be precluded from complying with a request for information from any other federal department or agency or an order of a court of the United States in an action brought by the United States or the SEC.

Section 404 also provides that any “proprietary information” of an investment adviser ascertained by the SEC from any report required to be filed under the Advisers Act shall not be subject to public disclosure and shall be exempt from Freedom of Information Act (“FOIA”) disclosure requirements. “Proprietary information” includes sensitive, nonpublic information regarding:

- the investment or trading strategies of the investment adviser;
- analytical or research methodologies;
- trading data;
- computer hardware or software containing intellectual property; and
- any additional information that the SEC determines to be proprietary.

Notwithstanding the confidentiality of the information, the SEC indicated that it may use information provided on Form PF in an enforcement action. In addition, these additional disclosure requirements likely will facilitate the SEC’s development of its exam strategy and additional SEC scrutiny of potential conflicts of interest, investor disclosures and valuation matters. Further, the FSOC may use this information provided on Form PF in determining whether an adviser or fund should be subject to additional regulation and prudential supervision under Title I of Dodd-Frank. In addition, advisers may need to consider how to address potential requests from investors seeking to obtain access to the information provided on Form PF with respect to the funds in which they have invested.

Logistics of Filing

Form PF will be filed through the IARD platform used for filing Form ADV, which is operated by FINRA. Advisers required to file Form PF will be required to pay filing fees in an amount to be approved by the SEC.

Additional Information

The Hunton & Williams Private Investment Funds practice group regularly represents funds, sponsors and a variety of investors in all types of private investment fund matters, including structuring, formation, offerings and compliance. We will continue to monitor the progress of the SEC’s rulemaking to implement Dodd-Frank’s requirements relating to investment advisers as well as relevant trends in private investment fund regulation.

For additional information on financial industry recovery proposals, see our related memoranda, available on <http://www.huntonfinancialindustryresourcecenter.com>. For additional information on recent legislation and regulations relating to regulation of private investment funds and their advisers, see our [prior memoranda](#) available on our website at www.hunton.com.

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