

ClientAlert

Capital Markets

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SEC Proposes Reporting Requirements for Private Fund Investment Advisers to Provide Systemic Risk Data to the FSOC

The Securities and Exchange Commission (the "SEC") recently proposed a rule that would require SEC-registered investment advisers to private funds to report specified financial, operational and portfolio information regarding the private funds they advise. This Client Alert discusses the requirements of the proposed rule and the steps investment advisers will have to take to comply with it.

Background

On January 26, 2011, the SEC proposed Rule 204(b)-1 under the Investment Advisers Act of 1940 (the "Advisers Act") to implement Sections 404 and 406 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). Given the Dodd-Frank Act's elimination of the registration exemption for advisers with fewer than 15 clients, many private fund managers will be subject to SEC registration and will thus be subject to the new private fund reporting requirements discussed herein. These new reporting requirements mandated by Congress were intended to provide critical data regarding private funds to the Financial Stability Oversight Council (the "FSOC"), which was created by the Dodd-Frank Act, so that that FSOC can assess and monitor systemic risk in the US financial system.

SEC Reporting Requirements

Proposed Advisers Act Rule 204(b)-1 ("Rule 204(b)-1") sets forth the filing requirements on new Form PF. In addition to providing the data reported on Form PF to the FSOC for the purposes discussed above, the SEC will also use the information to enhance its regulatory and investor protection programs and may use the information available to it in enforcement investigations involving investment advisers to private funds.

Rule 204(b)-1 applies to investment advisers that are registered with the SEC under the Advisers Act and that advise one or more private funds. For purposes of Rule 204(b)-1, a "private fund" is an issuer that would be an investment company under the Investment Company Act of 1940 ("Investment Company Act") but for the exclusion from the definition of investment company provided in either Sections 3(c)(1) or 3(c)(7) of the Investment Company Act. Proposed Form PF imposes different reporting requirements for private fund advisers depending on an adviser's assets under management ("AUM") and the types of private funds the adviser manages.



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Small Private Fund Advisers. Private fund advisers that are registered with the SEC and that have AUM of less than US\$1 billion are deemed small private fund advisers for purposes of Rule 204(b)-1. Small private fund advisers are required to file Section 1 of Form PF annually no later than the last day on which the adviser may timely file its annual updating amendment to Form ADV, which is currently 90 days after the end of the adviser's fiscal year.

Large Private Fund Advisers. Private fund advisers registered with the SEC with AUM of US\$1 billion or more are Large Private Fund Advisers under Rule 204(b)-1. To determine whether an adviser is a Large Private Fund Adviser, an adviser must aggregate with each private fund that it manages (1) the 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 (2) the assets of that type of private fund advised by any of the adviser's "related persons." For purposes of determining whether an adviser exceeds this threshold, an adviser must measure its AUM daily for hedge funds and liquidity funds, and quarterly for private equity funds. Large Private Fund Advisers must file Section 1 of Form PF as well as the additional sections described below depending on the type of funds they advise. In addition, these advisers must submit a Form PF on a quarterly basis, no later than 15 days after the end of each calendar quarter.

Hedge Funds. Form PF defines a "hedge fund" as any private fund that (1) has a performance fee or allocation calculated by taking into account unrealized gains, (2) may borrow an 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, or (3) may sell securities or other assets short. Large Private Fund Advisers to hedge funds must submit Section 2 of Form PF as well as Section 1.

Liquidity Funds. 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. Liquidity funds are similar to registered money market funds but are not subject to the extensive regulation to which registered money market funds are subject. Large Private Fund Advisers that manage liquidity funds must submit Section 3 of the Form PF as well as Section 1.

Private Equity Funds. A "private equity fund" is any private fund that is not a hedge fund, liquidity fund, real estate fund, securitized asset fund, or venture capital fund and which does not provide investors with redemption rights in the ordinary course; investors in such funds may not periodically redeem or transfer their interests in the fund without first meeting certain requirements

established by the fund. Large Private Fund Advisers that manage private equity funds must submit Section 4 of the Form PF as well as Section 1.

Confidentiality of Information Filed on Form PF

Form PF will be filed with the SEC electronically. Information advisers provide to the SEC on Form PF will not be made public. Rather, filings are kept confidential and are intended to be exempt from disclosure under the Freedom of Information Act.

Information Required to Be Filed on Form PF

Section 1. All private funds advisers submitting a Form PF must provide the information requested in Section 1. This section requires basic information about the adviser and the private funds advised, such as the capital structure, leverage and performance of the funds. Section 1 also requests information specifically from advisers that advise hedge funds; for example, a hedge fund adviser must provide information about the strategy, trading counterparties, and trading and clearing mechanisms of the hedge funds that it manages.

Section 2. Section 2 applies to Large Private Fund Advisers that advise hedge funds. This section requires detailed information about the hedge fund portfolios that it manages, both on an aggregate and fund-by-fund basis. Information that must be provided includes information regarding concentrated positions and geographic breakdown for all hedge funds. With regard to hedge funds that have a net asset value of at least US\$500 million on any day during the reporting period, the adviser must provide information on counterparty exposures, risk metrics, financing arrangements and fund investors. This information is required in order to help the FSOC gauge the extent to which distress at a particular hedge fund could spread to other market participants.

Section 3. Section 3 applies to Large Private Fund Advisers that advise liquidity funds. In this section, an adviser must provide information regarding the portfolios, performance, financing arrangements and investors of the liquidity funds that it manages. Certain information is required for each liquidity fund advised by the adviser regarding the fund's general portfolio and strategies. This information is aimed at assessing a liquidity fund's susceptibility to runs and its ability to otherwise pose systemic risk.

Section 4. Section 4 applies to Large Private Fund Advisers that advise private equity funds. Detailed information on the funds' portfolio and financing arrangements is requested. The Form PF also solicits information about these funds' leveraged buyouts in an attempt to monitor their interconnectedness with lending institutions.

Compliance Dates for Form PF

If approved, the SEC anticipates the proposed rule will have a compliance date of December 15, 2011. Large Private Fund Advisers would therefore need to file their initial Form PF by January 15, 2012. Small private fund advisers that are registered or required to be registered with the SEC as of the compliance date are granted a transition period of 90 days after the end of their then-current fiscal year before they must file their initial Form PF. Therefore, a small private fund adviser with a fiscal year ending December 31 would not have to file their initial Form PF until March 31, 2012. Newly registered private fund advisers, such as small private fund advisers that are not registered as of the compliance date, must file their initial Form PF no later than 15 days after the end of their next occurring calendar quarter after registering with the SEC.

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