

SEC Finalizes First Round of Form PF Updates

On May 3, 2023, the SEC voted three to two along party lines to issue a [final rule](#) updating Form PF requirements for hedge fund and private equity (PE) fund advisers as follows:

- Require large hedge fund advisers to report certain key events within 72 hours
- Require all PE fund advisers to report certain key events quarterly
- Require enhanced reporting by large PE fund advisers

The SEC heeded some comment letter feedback and scaled back some of the proposed disclosures, allowed for quarterly versus current reporting for PE advisers, and increased the current reporting deadline from one business day to 72 hours. The SEC will consider a second Form PF proposal issued jointly with the Commodity Futures Trading Commission (CFTC) and proposed changes for liquidity fund advisers at a future date.



Background

Form PF, adopted by the SEC and CFTC in 2011, provides the SEC and the Financial Stability Oversight Council (FSOC) with confidential information on basic operations and strategies of private funds to monitor and assess systemic risk. Form PF is submitted to regulators on a confidential basis and is not available to the public. Private funds are pooled investment vehicles that are excluded from the definition of “investment company” under the *Investment Company Act of 1940*. Private funds generally include funds commonly known as hedge funds and PE funds. An adviser must file Form PF if:

- It is registered or required to register with the SEC as an investment adviser
- It manages one or more private funds
- The adviser and its related persons have at least \$150 million in private fund assets under management (AUM) as of the last day of its most recently completed fiscal year

The annual report includes general information such as the types of private funds advised, fund size, use of borrowings and derivatives, strategy, and types of investors. Certain larger advisers report more frequently and include additional details on particular hedge funds and liquidity funds.

The private fund industry has grown to \$17 trillion. In the second quarter of 2022, there were 9,733 hedge funds reported on Form PF, managed by 1,857 advisers with \$9.4 trillion gross AUM, or about 50% of the private fund industry. In the second quarter of 2022, there were 18,987 PE funds reported on Form PF, managed by 1,635 advisers with \$6.4 trillion in gross AUM.

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Scope

The amendments apply to:

- Large hedge fund advisers – At least \$1.5 billion in AUM
- PE fund advisers – At least \$150 million AUM
- Large PE fund advisers – At least \$2 billion in private equity AUM (the SEC rejected a proposed drop in the AUM reporting threshold level from \$2 billion to \$1.5 billion)

I. Large Hedge Fund Advisers – Current Reporting – Key Events

The amendments require large hedge fund advisers to file a report within 72 hours of the following triggering events for their qualifying hedge funds (net asset value (NAV) of at least \$500 million). The 72-hour period begins upon the triggering of the current reporting event, or the time when the adviser reasonably believes that the event occurred and requires the adviser to respond to the best of its knowledge on the report date. For example, if an adviser determined that a current reporting event occurred on Monday at noon, it would have to file a current report as soon as practicable, but no later than Thursday before noon.

1. Extraordinary Investment Losses

A report requirement would be triggered if losses equal or greater than 20% of a fund's reported fund aggregate calculated value (RFACV) over a rolling 10-day period. This will capture a situation where the fund's RFACV is \$1 billion and the fund loses \$20 million per business day for a consecutive 10 business days. It also will capture a loss of \$200 million in one business day as the rolling 10-business-day period is backward looking. RFACV is defined as "every position in the reporting fund's portfolio, including cash and cash equivalents, short positions, and any fund-level borrowing, with the most recent price or value applied to the position for purposes of managing the investment portfolio" and may be calculated using the adviser's own methodologies and conventions of the adviser's service providers, if these are consistent with information reported internally. RFACV is calculated on a net basis and not on a gross basis. The rule notes that the calculation should include all items at their most recent, reasonable estimate, which will be marked-to-market for all holdings that can reasonably be marked daily.

If triggered, an adviser must report:

- The dates of the 10-business-day period over which the loss occurred
- The holding period return
- The dollar amount of the loss over the 10-business-day period

If the loss continues past the initial 10-business-day period, advisers will not report a second time until the fund has experienced a second loss of an additional 20% of the fund's RFACV over a second rolling 10-business-day period to begin on or after the end date stated in the adviser's initial current report.

2. Significant Margin & Default Events

- **Increases in Margin.** A report requirement would be triggered if a fund has experienced a cumulative increase in margin of more than 20% of the fund's average daily RFACV over a rolling 10-business-day period. For this metric, RFACV is the average of the daily RFACV for the end of the business day on business days one through 10 of the reporting period. Reporting is triggered if the total dollar value of margin, collateral, **or an equivalent** posted by the reporting fund at the end of a rolling 10-business-day period less the total dollar value of margin, collateral, or an equivalent posted by the reporting fund at the

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beginning of the rolling 10-business-day period is greater than or equal to 20% of the average daily RFACV during the period.

The inclusion of “or an equivalent” is designed to provide flexibility to account for funds’ unique circumstances.

If triggered, the adviser would need to report:

- The dates of the 10-business-day period over which the increase occurred
- The total dollar amount of the increase
- The total dollar value amount of margin, collateral or an equivalent posted by the reporting fund at both the beginning and the end of the 10-business-day period during which the increase was measured
- The average daily RFACV of the reporting fund during the 10-business-day period during which the increase was measured
- The identity of the counterparty or counterparties requiring the increase(s)

The adviser would use the following checkboxes to describe the reason for the margin increase:

- Exchange requirements or known regulatory action affecting one or more counterparties
- One or more counterparties independently increasing the fund’s margin requirements
- The fund establishing a new relationship or new business with one or more counterparties
- Fund’s new investment positions, investment approach or strategy, and/or portfolio turnover
- A deteriorating position(s) in the fund’s portfolio or other credit trigger under applicable counterparty agreements
- Other (with an explanatory note)

Advisers would not be required to file a report if there is a dispute on the margin call’s amount or appropriateness, if the fund has sufficient assets to meet the greatest of the disputed amount.

- **Fund Margin Default or Inability to Meet Margin Call.** Advisers must report a fund’s margin default or inability to meet a call for margin, collateral, or an equivalent (considering any contractually agreed cure period). If triggered, the following items must be disclosed for each separate counterparty:
 - The date the adviser determines or is notified that a reporting fund is in margin default or will be unable to meet a margin call for a counterparty
 - The dollar amount of the call for margin, collateral, or equivalent
 - The legal name and legal entity identifier (LEI) (if any) of the counterparty

The adviser also would use the following checkboxes to describe circumstances for the margin increase:

- An increase in margin requirements by the counterparty
- Losses in the value of the reporting fund’s portfolio or other credit trigger under the applicable counterparty agreement
- A default or settlement failure of a counterparty
- Other (with explanatory note)

3. Counterparty Default

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A report including the default date, dollar amount, and the counterparty's legal name would be triggered if a fund's counterparty:

- Does not meet a margin call or fails to make any other payment, as contractually required, after any contractually agreed cure period
- The amount is greater than 5% of RFACV

If multiple fund counterparties default on the same day, an adviser would file a single current report broken out with details for each counterparty default. If fund counterparties default on different days, the adviser would file a separate current report for each counterparty default that occurred.

4. Material Changes in Prime Broker Relationships

A current report would be triggered in two circumstances. The first is when the prime broker terminates the agreement or “materially restricts its relationship with the fund, in whole or in part, in markets where that prime broker continues to be active.” An example would be if a prime broker will no longer conduct certain trades on behalf of a U.S. fund in a particular market. However, if the same prime broker ceases activities in a market for all customers, this would not trigger a current report for an individual fund affected. The second trigger captures instances where there is a fund termination event as well as a cessation of the relationship whether initiated by the prime broker or the fund. A termination would need to be fund-specific and would not be reportable if the adviser understands that the termination was a part of a widespread change applicable to other of the prime broker's clients and isolated to the financial state, activities, or other characteristics solely of the prime broker. This also would include a current report for termination of the relationship between the prime broker and the reporting fund if the relationship between the prime broker and the reporting fund was terminated in the last 72 hours or less and a termination event in the prime brokerage arrangement was activated within the last 12 months. An example would be if a fund has repeatedly breached margin thresholds and is technically in default, but the prime broker has not terminated the relationship and at a later date asks the fund to find other prime brokerage services.

If triggered, an advisor would report:

- The date of the termination or material restriction (an explanatory note must be completed for a material restriction)
- The date of the termination event(s) if different
- The prime broker's legal name and LEI (if any)

5. Operational Events

A report would be required when the adviser or fund experiences a significant disruption or degradation of **critical operations**, whether as a result of an event at the fund, the adviser, or other service provider to the fund. Critical operations are operations necessary for:

- A fund's investment, trading, valuation, reporting, and risk management
- The operation of the reporting fund in accordance with federal securities laws and regulations

The final rule eliminates the proposal's 20% bright-line threshold but notes: “While we are not adopting the numeric threshold, we continue to believe that, in circumstances where operations are reasonably measurable, a 20 percent disruption or degradation of normal volume or capacity generally might be indicative of the types of stress for which reporting may be necessary.”

The report would include the date of the operation event and the date discovered and if the fund has initiated a business continuity plan. Check-the-box details would include if:

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- The event occurred at a service provider
- The event occurred at a fund or fund adviser or a related person
- The event is related to a natural disaster or other force majeure event
- Other (with an explanatory note)

The impact(s) should be categorized as follows:

- Trading of portfolio assets
- The valuation of portfolio assets
- The management of the fund's investment risk
- The ability to comply with applicable laws, rules, and regulations
- Other (with an explanatory note)

6. Withdrawals & Redemptions

Advisers currently provide certain redemption details on a quarterly basis. A current report would now be required if an adviser receives cumulative requests for redemption exceeding 50% of the most recent NAV (after netting with subscriptions and other contributions from investors received and contractually committed). Report details include:

- The date on which the net redemption requests exceeded 50% of the most recent NAV
- The net value of redemptions paid between the last Form PF reporting date and the date of the 50% trigger
- The percentage of the fund's NAV that the redemption requests represent
- Whether the adviser has notified the investors that the reporting fund will liquidate

A report also would be required if the fund either:

- Is unable to satisfy redemption requests, or
- Suspends redemptions for more than five consecutive business days

If triggered, disclosures include:

- The date the fund was unable to pay redemption requests or suspended redemptions
- The percentage of redemptions requested and not yet paid
- Whether the adviser has notified the investors that the fund will liquidate

In all the above situations, an adviser would be able to provide a narrative response with any additional details to help the SEC and FSOC evaluation of the situation.

II. All PE Fund Advisers – Quarterly – PE Event Reports – Section 6

The final rule requires all PE fund advisers to file a report within 60 days of the end of the fiscal quarter in the two below situations.

- **Adviser-Led Secondary Transactions.** An adviser-led secondary transaction is defined as any transaction initiated by the adviser or any of its related persons that offers fund investors the choice to sell all or a portion of their interests in the fund or convert or exchange all or a portion of their fund interests for interests in another vehicle advised by the adviser or any of its related persons. Transactions would only be subject to reporting if they are initiated by a PE fund's adviser or a related person of the adviser.

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- **Removal of a Fund’s General Partner (GP), Termination of a Fund’s Investment Period, or Fund Termination.** An adviser will have to report if a fund receives notification that fund investors have removed the adviser or an affiliate as the GP or similar control person of a fund, elected to terminate the fund’s investment period, or elected to terminate the fund. An adviser would report the effective date of the applicable removal event and a description of the removal event.

In both of the above situations, an adviser would be able to provide a narrative response with any additional details to help the SEC and FSOC evaluation of the situation.

III. Large PE Fund Advisers – Annual Reporting – Section 4

The proposal would have reduced the threshold for reporting as a large PE adviser from \$2 billion to \$1.5 billion in AUM. This was dropped from the final rule as additional research indicated this threshold covers 73% of the PE industry.

The final rule amends Section 4 of Form PF to gather additional information as follows:

1. GP or Limited Partner (LP) Clawbacks

A GP clawback is defined as any obligation of the GP, its related persons, or their respective owners or interest holders to restore or otherwise return performance-based compensation to the fund under the fund’s governing agreements. For example, if a fund’s GP is entitled to performance-based compensation equaling 20% of the fund’s profits over the fund’s life and the fund distributes this compensation to the GP periodically based on the fund’s profitability at the time of distribution, the GP may have received distributions in excess of 20% of the fund’s aggregate profits. In this situation, under the fund’s governing documents, the fund’s GP would be required to return the excess performance-based compensation received. Reporting would be required when the GP is required to return to the fund performance-based compensation in excess of the amount it was ultimately entitled to receive under the fund’s governing documents.

An LP clawback is defined as an obligation of a fund’s investors to return all or any portion of a distribution made by the fund to satisfy a liability, obligation, or expense of the fund pursuant to the fund’s governing agreements.

Reporting will be required for any GP clawback or LP clawback in excess of an aggregate amount equal to 10% of a fund’s aggregate capital commitments. Advisers generally should file for each additional LP clawback, regardless of its size, over the course of such fund’s remaining life once such fund’s aggregate LP clawbacks have exceeded this 10% threshold.

2. Fund Investment Strategies

A fund would choose from a mutually exclusive list of strategies by percentage of deployed capital even if the categories do not precisely match the characterization of the fund’s strategies. If a reporting fund engages in multiple strategies, the adviser would provide a good faith estimate of the percentage the reporting fund’s deployed capital represented by each strategy.

3. Fund-Level Borrowings

Advisers would be required to report whether a fund borrows or has the ability to borrow at the fund level as an alternative or complement to the financing of portfolio companies. If a fund engages in fund-level borrowing, the following information is required:

- Information on each borrowing or other cash financing available to the fund
- The total dollar amount available
- The average amount borrowed over the reporting period

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4. Default, Bridge Financing, & Geographic Details

Several existing questions would be amended:

- Question 74 would be updated to require more granular information about the nature of reported default events, such as whether it is a payment default of the PE fund, a payment default of a capital pool company (CPC), or a default relating to a failure to uphold terms under the applicable borrowing agreement (other than a failure to make regularly scheduled payments).
- Question 75 currently requires reporting on the identity of the institutions providing bridge financing to the adviser's CPCs and the financing amount. The update would require additional counterparty identifying information and if the counterparty is affiliated with a major financial institution and the financial institution's name.
- Question 78 currently requires reporting on the geographical breakdown of fund investments. The question would be amended to require an advisor to report all countries (by ISO code) to which a fund has exposure of 10% or more of NAV.

Next Steps

The SEC will consider finalizing an August 2022 proposal issued jointly with the CFTC that covers private funds, commodity pool operators, and commodity trading advisors. Significant changes include:

- Section 1 and general instruction changes – Applicable to all Form PF filers
 - New details on advisers and the private funds they advise, including a breakout of digital assets
 - Reporting of complex structures
 - Enhanced reporting on hedge funds
- Section 2 changes – Applicable to large hedge fund advisers who advise qualifying hedge funds
 - Enhanced reporting
 - Removal of aggregate reporting

Resource: [SEC Proposes Second Set of Form PF Disclosure Updates](#)

The SEC will deliberate separately proposed disclosures for large liquidity fund advisers. Liquidity funds follow similar investment strategies as money market funds (MMFs) but are unregistered. Similar to MMFs, liquidity funds are managed to maintain a stable NAV or minimizing principal volatility and typically invest in high-quality, short-term debt securities, such as Treasury bills, repurchase agreements, or commercial paper, that fluctuate very little in value under normal market conditions. Currently, liquidity fund advisers with between \$150 million and \$1 billion in assets file Form PF annually. Large liquidity fund advisers with at least \$1 billion in combined AUM attributable to unregistered liquidity funds and registered MMFs are required to file Form PF quarterly. The proposal would require large liquidity fund advisers to report substantially the same information that MMFs report on Form N-MFP, including:

- Operational information
- Assets and portfolio details
- Counterparty and clearing information for repo transactions
- Financing information
- Investor information
- Disposition of portfolio securities
- Weighted average maturity (WAM) and weighted average life (WAL)

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Conclusion

The asset management team at Forvis Mazars has more than 50 years of experience providing accounting, tax, and consulting services to various types of investment holdings, including conventional debt and equity investments, loans, businesses, alternative investments, and other unique assets. As of August 2022, Convergence Optimal Performance ranked Forvis Mazars as a top 25 accounting and audit firm to registered investment advisors. Forvis Mazars also was ranked in the top 20 by AUM. We have experience providing services to fund complexes with net assets ranging from a couple million to several billion dollars. Our experience allows us to provide tailored services to help meet your unique needs. For more information, visit forvismazars.us.

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