US Securities and Exchange Commission Proposes New Reporting Rules for Advisers to Private Funds

On January 25, 2011, the US Securities and Exchange Commission (SEC) and the US Commodity Futures Trading Commission (CFTC) jointly proposed rules that would require reporting by investment advisers to certain types of pooled investment vehicles on new Form PF (the "Proposal").[1] The Proposal is intended to implement provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act requiring investment advisers to certain types of pooled investment vehicles to submit reports to the SEC that would be used by the newly created Financial Stability Oversight Council (FSOC) in assessing risks to US financial stability and systemic risk.[2]

The SEC and CFTC explained that the Proposal is based on, among other things, consultations with the UK Financial Services Authority, which has conducted a voluntary semi-annual survey of hedge fund advisers since 2009, and with the Hong Kong Securities and Futures Commission regarding its oversight of hedge funds. As a result, some advisers may already be familiar with the types of information being requested by the proposed Form PF.

Although the Proposal will be applicable to CFTC-registered "commodity pool operators" or "commodity trading advisors," this legal update deals specifically with issues related to SEC-registered investment advisers.

The comment period on the Proposal will be open until April 12, 2011, 60 days after publication in the *Federal Register*.

Who Would File?

The Proposal would require Form PF filings from all investment advisers registered or required to be registered under the Investment Advisers Act of 1940 (the "Advisers Act") and that advise at least one "private fund" (RIAs). Section 202(a)(29) of the Advisers Act defines a "private fund" as "an issuer that would be an investment company … but for Section 3(c)(1) or 3(c)(7) of [the Investment Company Act of 1940]." As a result, pooled investment companies that rely on other exceptions or exemptions under the Investment Company Act of 1940, such as real estate funds that rely on Section 3(c)(5)(C) or securitization vehicles that rely on Rule 3a-7, are not "private funds" and are outside the scope of the Proposal.

The Proposal would *not* require Form PF filings from investment advisers that are not required to register with the SEC because they are "foreign private advisers" or because they are exempt reporting advisers relying on the (proposed) registration exemptions for small private fund advisers or for advisers to venture capital funds.[3]

COMBINED AND COORDINATED FILINGS

The Proposal would allow—but not require—an RIA to consolidate its reporting with its "related persons" (as defined in Form ADV). With respect

to a sub-advised or multiple manager fund, only one RIA would file with respect to that fund. The RIA required to report would be the RIA that disclosed the fund on its Form ADV Part 1 Schedule D, Section 7.B.1 (if amended as proposed).[4]

NON-US RIAS

An RIA that has its "principal office and place of business" (as defined in Form ADV) outside of the United States would be permitted to exclude from their reports any private fund that during the RIA's last fiscal year (i) was not itself a "US person" (as defined in proposed rule 203(m)-1[5]), and (ii) was not offered to, or beneficially owned by, a US person. If *all* of a non-US RIA's private fund clients met this test, it would not be required to file Form PF at all.

When Must RIAs File?

Generally, the Proposal would require RIAs to file Form PF with the SEC annually within 90 days of their fiscal year-end, putting this filing on the same timetable as their requirement to annually update and file their Form ADV. However, certain RIAs would file quarterly reports. Specifically, quarterly filings would be required for RIAs that, together with their related persons:

- Have more than $1 billion in assets under management (AUM) attributable to "hedge funds," as of the close of business of any day during the most recently completed calendar quarter;
- Have more than $1 billion in AUM attributable to "liquidity funds" and Rule 2a-7 money market funds, as of the close of business of any day during the most recently completed calendar quarter;[6] or
- Have more than $1 billion in AUM attributable to "private equity funds," as of the close of business of the last day of the most recently completed calendar quarter.

Each of these AUM levels is based on "regulatory assets under management" as calculated in the proposed amended Form ADV. As such, each would include assets even if they are not "securities portfolios" (as defined in Form ADV). These AUM levels would also require aggregation of AUM from "parallel funds" and "parallel managed accounts" (respectively, other private funds, or managed accounts or other pools of assets, that the RIA or a related person advises and that pursues substantially the same investment objective and strategy and invests side by side in substantially the same positions as an advised private fund), also without respect to whether those assets are "securities portfolios." However, assets of "fund of funds" (i.e., private funds that invest solely in other private funds) would not count toward these AUM thresholds. *Note that under the Proposal, the AUM/aggregation rules for these purposes differ from those used elsewhere in the form.*

Once an RIA passes the $1 billion threshold for any particular type of fund, it would file additional information with respect to that type of fund on a quarterly basis. There are no proposed quarterly filing requirements with respect to real estate funds, securitized asset funds or venture capital funds.

Quarterly reports would be due 15 days after the end of the relevant quarter.

What are the Reporting Requirements?

The amount and type of information that an RIA would be required to report would vary based on the value of its AUM and the types of funds it advises. Most RIAs would be required to provide only basic information about their funds. Certain larger RIAs would be required to provide additional information.

ANNUAL FILINGS

In addition to general identifying information about the RIAs, the form would require them to disclose aggregate private fund information, including total and net AUM[7] attributable to:

- "Hedge funds"—any private fund that: has a performance fee or allocation calculated by taking into account unrealized gains; may borrow an amount in excess of 50 percent of its net asset value (including capital commitments) (NAV) or may have gross notional exposure in excess of twice its NAV; or may sell assets short;[8]
- "Liquidity funds"—any private fund that seeks to generate income by investing in a portfolio of short-term obligations in order to maintain a stable NAV per unit or minimize principal volatility for investors;
- "Private equity funds"—any private fund that (i) is not a hedge fund, liquidity fund, real estate fund, securitized asset fund or venture capital fund, and (ii) does not provide investors with redemption rights in the ordinary course;
- "Real estate funds"—any private fund that is not a hedge fund; does not provide investors with redemption rights in the ordinary course; and invests primarily in real estate and real estate related assets;[9]
- "Securitized asset funds"—any private fund that is not a hedge fund; that issues asset backed securities; and whose investors are primarily debt-holders;[10]
- "Venture capital funds"—as defined in proposed Rule 203(l)-1;[11]
- Other private funds; and
- Funds and accounts other than private funds.

In addition to requiring certain identifying information, the form also would require RIAs to provide other basic information about each advised private fund, such as information regarding NAV, leverage, creditors, derivatives positions, investor concentration, and monthly and quarterly performance. Additional information regarding hedge funds would also be required, including the strategies used for the fund, the use of computer-driven trading strategies, the identity of certain trading counterparties and the use of certain trading and clearing mechanisms.

QUARTERLY FILINGS

The quarterly reports solicit all of the information require in an annual report, plus more detailed information for specific types of private funds if the thresholds noted above are triggered.

Hedge Funds. Filers that reach the $1 billion threshold for hedge funds would provide aggregate information regarding all of their hedge funds, such as turnover rate, geographic exposure and month-by-month long and short exposure to certain assets classes. They would also provide information on a fund-by-fund basis for each hedge fund that has, together with any "parallel funds" and "parallel managed accounts," an NAV of at least $500 million as of the close of business on any day during the most recently completed calendar quarter. This fund-by-fund reporting would include information such as monthly long and short exposure, fund liquidity buckets, trading counterparty exposure and investor liquidity (such as the use of gates and the ability to meet redemption requests).

Liquidity Funds. Filers that reach the $1 billion threshold for liquidity funds and Rule 2a-7 money market funds would provide information on a fund-by-fund basis for all liquidity funds (together with any parallel managed accounts — but not including money market funds), such as how closely the liquidity fund complies with provisions of Rule 2a-7 (and month-by-month reporting of related information, such as market-based NAV, weighted average maturity and daily and weekly liquid asset levels), information on maturity of assets held by the fund, information on borrowings and information on investor concentration and liquidity.

Private Equity Funds. Filers that reach the $1 billion threshold for private equity funds would provide information on a fund-by-fund basis for all private equity funds (together with

any parallel managed accounts), such as information on borrowing facilities, portfolio company bridge loans and debt-to-equity ratios, and geographic exposure of investments. In addition, if any of the private equity funds invest in certain types of financial companies (e.g., banks), the filer would also provide additional information regarding those investments (including the identity of the financial institution).

Confidentiality and Use of Reported Information

The SEC specifically recognized the potential for adverse consequences to private funds and their investors if the information became public and as a general matter, the Proposal would treat all information in Form PF filings as confidential to the extent permitted under applicable law.[12] That said, the information in Form PF filings would be shared with FSOC, and the SEC also noted that it would share information with foreign financial regulators[13] and indicated that it might also publicly release non-identifying, aggregated data submitted by all filers. In addition, the Proposal noted that the SEC would be able to use data collected as part of Form PF filings in enforcement actions.[14]

Filing Procedures

The Proposal would call for electronic filings of Form PF. In the Proposal, the SEC noted that it might make use of the existing IARD system that RIAs use to file Form ADV, although it noted that the fees related to Form PF filings would likely be greater than existing Form ADV filing fees.[15]

Proposed Effective and Compliance Dates

The SEC currently anticipates that the proposed rules would have a compliance date of December 15, 2011. After this date, quarterly Form PF filers would make their first quarterly filing by January 15, 2012. Annual Form PF filers with a fiscal year end of December 31 would make their first annual filing by March 31, 2012.

Endnotes

[1] Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF, Advisers Act Rel. No. 3145 (Jan. 26, 2010), available at http://www.sec.gov/rules/proposed/2011/ia-3145.pdf.

[2] The Proposal noted that a future release would address recordkeeping requirements specific to private fund advisers. *Id.* at n.51.

[3] *See* Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers with Less Than $150 Million in Assets Under Management, and Foreign Private Advisers, Advisers Act Rel. No. 3111 (Nov. 19, 2010) [75 Fed. Reg. 77190 (Dec. 10, 2010)] (Exemptions Release), available at http://www.sec.gov/rules/proposed/2010/ia-3111fr.pdf.

[4] As proposed, only a single RIA would disclose any particular private fund in its Form ADV Part 1 Schedule D, Section 7.B.1, even if advised (or sub-advised) by multiple RIAs.

[5] Proposed rule 203(m)-1(e)(8) would define United States person by reference to the Rule 902(k) of Regulation S, "except that any discretionary account or similar account that is held for the benefit of a United States person by a dealer or other professional fiduciary is a United States person if the dealer or professional fiduciary is a related person of the investment adviser … and is not organized, incorporated or (if an individual) resident in the United States." *See* Exemptions Release, *supra* note 3.

[6] Although assets under management attributable to money market funds count towards the $1 billion threshold for determining whether an RIA would file Form PF quarterly, the reports do not solicit information about such funds (except to the extent they are included as "parallel funds").

[7] "Net" assets under management refers to the RIA's regulatory AUM minus any outstanding indebtedness or other accrued but unpaid liabilities.

[8] For purposes of certain sections of the Form, the Proposal would also include commodity pools that are private funds as "hedge funds."

[9] This would only apply to real estate funds that are private funds, i.e., a real estate fund that does not rely on Section 3(c)(1) or 3(c)(7) and instead only relies on Section 3(c)(5)(C), would not fall within the definition.

[10] This would only apply to securitized asset funds that are private funds, i.e., a securitized asset fund that does not rely on Section 3(c)(1) or 3(c)(7) and instead only relies on Rule 3a-7, would not fall within the definition.

[11] *See* Exemptions Release, *supra* note 3.

[12] *See* Proposal, *supra* note 1 at 14, n.39 and accompanying text.

[13] *See id.* at n.23. Information sharing with foreign financial regulators would be done under information sharing agreements where the foreign regulator agreed to keep the information confidential.

[14] *See id.* at n.39 and accompanying text.

[15] *See id.* at n.147 and accompanying text.

If you have questions regarding these developments, please contact the Mayer Brown lawyer with whom you normally communicate or any of the following lawyers.

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