CLIENT ALERT

SEC Proposes Amendments to Form PF to Enhance Private Fund Reporting

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On January 26, 2022, the Securities and Exchange Commission (the "SEC") voted 3-1 to propose amendments to Form PF and related rule amendments (the "Proposed Amendments").[1] Form PF is the confidential reporting form used by certain SEC-registered investment advisers to private funds, and provides the SEC and the Financial Stability Oversight Counsel ("FSOC") with information about the operations and strategies of private funds.[2] The SEC stated that the Proposed Amendments are designed to enhance FSOC's ability to monitor systemic risk and collect additional information for the SEC's use in its regulatory programs, including examinations, investigations, and investor protection efforts relating to private fund advisers.[3]

1 *See* Amendments to Form PF to Require Current Reporting and Amend Reporting Requirements for Large Private Equity Advisers and Large Liquidity Fund Advisers, Investment Advisers Act Release No. 5950 (Jan. 26, 2022) (the "Proposing Release"), available here.

2 A private fund adviser is required to complete Form PF if (A) (i) it is registered or required to register with the SEC as an investment adviser or (ii) it is registered or required to register with the Commodity Futures Trading Commission as a Commodity Pool Operator or Commodity Trading Advisor and also registered or required to register with the SEC as an investment adviser; (B) it manages one or more private funds, and (C) it and its related persons, collectively, had at least $150 million in private fund assets under management as of the last day of its most recently completed fiscal year. The current version of Form PF is available here.

3 One day after the SEC voted to propose the amendments, the SEC's Division of Examinations released a risk alert based on observations from examinations of private fund advisers, which serves to underscore the SEC's current regulatory focus on private funds and private fund advisers. *See* Observations from Examinations of Private Fund Advisers (Jan. 27, 2022), available here.

Background

Form PF provides the SEC and FSOC with information about the operations and strategies of private funds,[4] and the Form is designed to support the SEC's and FSOC's assessment of systemic risk. Since Form PF was initially adopted in 2011, the private fund industry has grown in size and evolved in terms of business practices, complexity of fund structures, and investment strategies and exposures. The value of private fund net assets reported on Form PF more than doubled between 2013 to 2020, from $5 trillion to $11 trillion, while the number of private funds reported on Form PF increased by nearly 70 percent in the same period.[5]

In light of these developments, the SEC and FSOC identified "significant information gaps and situations" where they believe more detailed and timely information would improve their understanding of the private fund industry and the potential systemic risk the industry poses, and improve the SEC's ability to protect investors.[6] The Proposed Amendments would affect the Form PF filings made by "large hedge fund advisers," "private equity advisers," and "large liquidity fund advisers," as those classifications are defined under the Form.

The Proposed Amendments

The Proposed Amendments include four primary changes to Form PF, as outlined below. Notably, the Proposed Amendments would require advisers to report certain events within *one business day* of the event. Reporting within one business day marks a significant change from the current form's delayed quarterly and annual filing requirements. As described in the Proposing Release, the SEC believes that recent market events like the March 2020 COVID-19 turmoil and the January 2021 market volatility in certain stocks have highlighted the importance of receiving current information from market participants during fast-moving market events. According to the SEC, requiring advisers to report the occurrence of such events within one business day would facilitate a regulatory response if appropriate and potentially mitigate the impact on investors and systemic risk. Such reports would also allow the SEC and FSOC to identify patterns among similarly situated funds that could indicate broader system implications or investor protection concerns.

[4] Private funds are pooled investment vehicles that are excluded from the definition of "investment company" under the Investment Company Act of 1940 by Section 3(c)(1) or 3(c)(7) of that act. The term "private fund" generally includes funds commonly known as hedge funds and private equity funds.

[5] *See* Proposing Release at n.4.

[6] *See* Proposing Release at 5.

1. New Current Reporting for Large Hedge Fund Advisers

The Proposed Amendments would add a new Section 5 to Form PF to require large hedge fund advisers[7] to file current reports within *one business day* of the occurrence of one or more reporting events that indicate significant stress or otherwise serve as signals of systemic risk implications, as well as potential areas for inquiry with respect to their qualifying hedge funds.[8] The reporting events, each of which is detailed further below, would include certain extraordinary investment losses, significant margin and counterparty default events, material changes in prime broker relationships, changes in unencumbered cash, operations events, and events associated with investor withdrawals and redemptions. Under proposed Item K for Section 5, advisers would have the ability to provide a narrative response if they believe that additional information would be helpful in the current report. A current report under Section 5 would be filed as a stand-alone document and advisers would not be required to file any other part of Form PF at the time a current report is filed. The Proposed Amendments also include conforming changes to Rule 204(b)-1 under the Investment Advisers Act of 1940 to re-designate current Section 5 of Form PF, which includes instructions for requesting a temporary hardship exemption, as Section 7.

Extraordinary Investment Losses

Reporting extraordinary investment losses would be triggered by a loss equal to or greater than 20 percent of a fund's "most recent net asset value"[9] ("NAV") over a rolling 10 business day period. The Proposing Release notes that this information could provide notice to the SEC and FSOC of potential fund or market issues in advance of the occurrence of more downstream consequences. In the event of an extraordinary loss, an adviser would be required to report the date(s) of the 10 business day period over which the loss(es) occurred and the dollar amount of the loss(es). If the fund were to continue to incur losses, the adviser would be required to file another current report covering the next applicable 10 business day loss period beginning on or after the end-date stated in the adviser's initial report.

Significant Margin and Counterparty Default Events

Under the Proposed Amendments, advisers would be required to report three primary events related to margin. First, advisers would be required to report if a fund has experienced a cumulative increase in margin of more than 20 percent of

7 A "large hedge fund adviser" is any adviser having at least $1.5 billion in regulatory assets under management attributable to hedge funds as of the end of any month in the prior fiscal quarter.

8 A "qualifying hedge fund" is defined in Form PF as "any hedge fund that has a net asset value (individually or in combination with any feeder funds, parallel funds, and/or dependent parallel managed accounts) of at least $500 million as of the last day of any month in the fiscal quarter immediately preceding your most recently completed fiscal quarter."

9 The term "most recent net asset value" would be defined as "as of the data reporting date at the end of the reporting fund's most recent reporting period," which the SEC noted typically would be the most recent update to the fund's routine quarterly or annual Form PF filing. *See* Proposing Release at n.23 and accompanying text.

the fund's NAV over a rolling 10 business day period. The adviser would be required to report (i) the dates of the 10 business day period over which the increase occurred, (ii) the cumulative dollar amount of the increase, and (iii) the identity of the counterparty or counterparties requiring increases. The adviser also would check certain boxes to describe the circumstances of the margin increase. The SEC believes that this information would better enable the SEC and FSOC to screen false positives (*i.e.*, incidents that trigger the proposed current reporting requirement but do not actually raise significant risks) and assess significant margin events.

Second, advisers would be required to report a fund's margin default or inability to meet a call for margin, collateral, or an equivalent (taking into account any contractually agreed cure period). These circumstances would include situations where there is a dispute with regard to the margin call, but a current report would not be required when there is a dispute as to the amount and appropriateness of the margin call so long as the fund has sufficient assets to meet the greatest of the disputed amount. The adviser would be required to report (i) the date the adviser determines or is notified that a fund is in margin default or will be unable to meet a margin call with respect to a counterparty, (ii) the dollar amount of the margin, collateral, or equivalent involved, and (iii) the legal name and legal entity identifier ("LEI") (if any) of the counterparty. The adviser also would check certain boxes to describe the circumstances of the fund's default or its determination that the fund will be unable to meet a call for increased margin.

Finally, advisers would be required to report if (i) a counterparty to a fund does not meet a call for margin or has failed to make any other payment, in the time and form contractually required (taking into account any contractually agreed cure period) and (ii) the amount involved is greater than 5 percent of the NAV of the fund. The adviser would be required to report (i) the date of the default, (ii) the dollar amount of the default, and (iii) the legal name and LEI (if any) of the counterparty.

Material Changes in Prime Broker Relationships

Advisers would be required to report a material change in the relationship between a fund and its prime broker(s). The SEC believes that material changes in a fund's prime brokerage relationship may signal that the fund or the brokers with whom the fund transacts are experiencing stress and may be subject to an increased risk of default or, in the case of the fund, potential liquidation. A material event would include material changes to the fund's ability to trade or an outright termination of the prime brokerage relationship. The adviser would report the date of the material change and the legal name and LEI (if any) of the prime broker involved, in addition to selecting checkboxes that describe the circumstances relating to the material change, including, in the case of a termination of a prime brokerage relationship, whether the termination was due to default or breach of agreement by either party.

Changes in Unencumbered Cash

Advisers would be required to report if the value of a fund's unencumbered cash declines by more than 20 percent of the fund's NAV over a rolling 10 business day period. Under these circumstances, the adviser would be required to report the last day of the rolling 10 business day period during which the unencumbered cash declined and the dollar amount of the unencumbered cash on that last day of the period, in addition to selecting checkboxes that provide additional information concerning the adviser's current understanding of the facts and circumstances around the change in unencumbered cash. If the decrease in unencumbered cash were to continue past the initial 10 business day period, advisers would be required to file a subsequent report covering the next applicable 10 business day period beginning on or after the end-date stated in the adviser's initial report.

Operations Events

Advisers would be required to report when the adviser or a fund experiences a "significant disruption or degradation" of the fund's "key operations," whether as a result of an event at the fund, the adviser, or other service provider to the fund. "Key operations" would be defined to mean operations necessary for (i) the investment, trading, valuation, reporting, and risk management of the fund and (ii) the operation of the fund in accordance with the Federal securities laws and regulations. When evaluating a fund's key operations that are reasonably measurable, a "significant disruption or degradation" means a 20 percent disruption or degradation of normal volume or capacity. For example, advisers would be required to report events such as a severe weather event causing wide-spread power outages that significantly disrupt or degrade key operations. Advisers would have to report the date of the operations event (or an estimate of when it occurred), and the date the operations event was discovered, in addition to selecting checkboxes that provide additional information concerning the circumstances relating to the operations event and its impact on the normal operations of the fund. The Proposed Amendments would not require advisers to file subsequent reports if the event were to continue after the initial filing or upon conclusion of the event.

Events Associated with Withdrawals and Redemptions

The SEC believes that large redemption requests, suspensions of withdrawals/redemptions, material restrictions on withdrawals/redemptions, and an inability to satisfy redemptions are significant signals of potential stress at a fund. As a result, reporting would be triggered under this category if the adviser receives cumulative requests for redemption exceeding 50 percent of the most recent NAV (after netting against subscriptions and other contributions from investors received and contractually committed). The adviser would report (i) the date on which the net redemption requests exceeded 50 percent of the most recent NAV, (ii) the net value of redemptions paid from the fund between the last data reporting date (the end of the most recently reported fiscal quarter on Form PF) and the date of the current report, (iii) the percentage of the fund's NAV the redemption requests represent, and (iv) whether the adviser has notified the investors that the fund will liquidate. In addition, reporting would be triggered if a fund is unable to satisfy redemptions or suspends redemptions for more than five consecutive business days. Under these circumstances, the adviser would report (i) the date the fund was unable to pay redemption requests or suspended redemptions, (ii) the percentage of redemptions requested and not yet paid, and (iii) whether the adviser has notified the investors that the fund will liquidate.

2. *New Current Reporting for Advisers to Private Equity Funds*

The Proposed Amendments would add a new Section 6 to Form PF to require advisers to private equity funds to file current reports within *one business day* of the occurrence of one or more reporting events pertaining to the execution of adviser-led secondary transactions, implementation of general partner or limited partner clawbacks, removal of a fund's general partner, termination of a fund's investment period, or termination of a fund, each of which is described in further detail below. As with current reports under Section 5, advisers would have the ability under proposed Item E of Section 6 to provide a narrative response if additional information would be helpful in the current report. A current report under Section 6 would be filed as a stand-alone document and advisers would not be required to file any other part of Form PF at the time a current report is filed.

Adviser-Led Secondary Transactions

Advisers would be required to report upon the completion of an adviser-led secondary transaction. Under the Proposed Amendments, "adviser-led secondary transaction" would mean any transaction initiated by the adviser or any of its related persons that offers private equity fund investors the choice to (i) sell all or a portion of their interests in the fund or (ii) convert or exchange all or a portion of their interests in the fund for interests in another vehicle advised by the adviser or any of its related persons. Transactions would be subject to reporting only if they were initiated by a private equity fund's adviser or a related person of the adviser. The adviser would report the transaction completion date and a brief description of the transaction.

Implementation of General Partner or Limited Partner Clawbacks

Advisers would be required to report upon the implementation of a "general partner clawback," or upon the implementation of a "limited partner clawback," in excess of an aggregate amount equal to 10 percent of a fund's aggregate capital commitments. The term "general partner clawback" would be defined as any obligation of the general partner, its related persons, or their respective owners or interest holders to restore or otherwise return performance-based compensation to the fund pursuant to the fund's governing agreements. The term "limited partner clawback" would be 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.

Removal of General Partner, Termination of the Investment Period, or Termination of a Fund

Advisers would be required to report when a fund receives notification that fund investors have (i) removed the adviser or an affiliate as the general partner or similar control person of a fund, (ii) elected to terminate the fund's investment period, or (iii) elected to terminate the fund, in each case as contemplated by the relevant fund documents. Advisers would report the effective date of the applicable removal event and a description of such removal event.

3. Large Private Equity Adviser Reporting

The Proposed Amendments would reduce the threshold for reporting as a large private equity adviser from $2 billion to $1.5 billion in private equity fund regulatory assets under management. The SEC believes that by lowering the threshold, the SEC and FSOC would receive reporting from a similar proportion of the U.S. private equity industry based on committed capital as when Form PF was initially adopted in 2011.[10] Additionally, the Proposed Amendments would amend Section 4 of Form PF for large private equity advisers to add new questions regarding fund investment strategies, portfolio company restructurings or recapitalizations, fund investments in different levels of a single portfolio company's capital structure, fund-level borrowings, financing of portfolio companies, controlled portfolio companies ("CPCs") and CPC borrowings, and events of default, financing to controlled portfolio companies, and geographic breakdown of investments. We discuss each in more detail below.

Private Equity Fund Investment Strategies

Currently, Form PF does not require advisers to report information about private equity fund strategies, but given the growth in the industry since the adoption of Form PF and the diversity of strategies employed by private equity funds, the SEC believes that it is important to begin collecting such information. The Proposing Release explains that strategy information would allow the SEC and FSOC to understand and monitor better the potential market and systemic risks presented by the different strategies to both markets and investors.

The Proposed Amendments would require advisers to indicate each fund's investment strategy(ies) by percent of deployed capital, choosing from a mutually exclusive list of strategies (even if the categories do not precisely match the characterization of the fund's strategies). If a fund engages in multiple strategies, the adviser would provide a good faith estimate of the percentage of the fund's deployed capital represented by each strategy. The adviser would be permitted to choose an "other" category if the fund's strategy is not listed, but the adviser would have to explain why it is selecting the "other" category.

[10] *See* Proposing Releases at 8.

Restructuring or Recapitalization of a Portfolio Company

Advisers would be required to identify any portfolio company that was restructured or recapitalized following the end of the fund's investment period, and the effective date of the restructuring.

Investments in Different Levels of a Single Portfolio Company's Capital Structure by Related Funds

Advisers would be required to indicate whether a fund held an investment in one class, series, or type of securities (*e.g*., debt, equity, etc.) of a portfolio company while another fund advised by the same adviser or its related persons concurrently held an investment in a different class, series, or type of securities of the same portfolio company. In such circumstances, the adviser would be required to provide the name of the portfolio company and a description of the class, series, or type of securities held. The Proposing Release notes that investments in different parts of a portfolio company's capital structure can create conflicts of interest that are important for the SEC to monitor for investor protection efforts and for enhancing the SEC's understanding of market trends.

Fund-Level Borrowings

Advisers would be required to report whether a private equity fund borrows or has the ability to borrow at the fund-level as an alternative or as a complement to the financing of portfolio companies. If a fund engages in fund-level borrowing, the advisers would be required to provide (i) information on each borrowing or other cash financing available to the fund, (ii) the total dollar amount available, and (iii) the average amount borrowed over the reporting period. This new reporting category is designed to collect data that the SEC believes would provide valuable insight into how private equity funds obtain leverage, thereby giving the SEC and FSOC a better understanding of a fund's risk profile.

Financing of Portfolio Companies

Advisers would be required to report whether they or any of their related persons provide financing or otherwise extend credit to any portfolio company in which a fund invests and to quantify the value of such financing or other extension of credit. The Proposing Release notes that such information would help the SEC identify possible conflicts of interest that would help the SEC focus its risk-based exam program, and could also alert the SEC to industry financing trends that could affect systemic risk concerns.

Floating Rate Borrowings of CPCs; CPCs Owned by Private Equity Funds

Advisers would be required to report what percentage of the aggregate borrowings of a private equity fund's CPC is at a floating rate rather than a fixed rate. Advisers also would have to report how many CPCs a private equity fund owns.

Events of Default, Bridge Financing to CPCs, and Geographic Breakdown of Investments

Advisers would be required to provide more detailed information about the nature of reported events of default under borrowing arrangements, such as whether an event of default is a payment default of the private equity fund, a payment default of a 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). Advisers also would be required to identify institutions providing financings to CPCs, provide the amount of such financings, and provide additional counterparty identifying information, including whether the counterparty is affiliated with a major financial institution, and, if so, the name of the financial institution. The Proposed Amendments would also modify how advisers report the geographical breakdown of investments by moving away from reporting based on a static group of regions and countries and towards identifying a private equity fund's greatest country exposures based on percentage of NAV. An adviser would report all countries (by ISO country code) to which a fund has exposure of 10 percent or more of its NAV.

4. Large Liquidity Fund Adviser Reporting

The Proposed Amendments would require large liquidity fund advisers[11] to report substantially the same information that money market funds would report on Form N-MFP (as amended as proposed in 2021).[12] The Proposed Amendments would revise how large liquidity fund advisers report operational information, such as whether a liquidity fund seeks to maintain a stable price per share, and how large liquidity fund advisers report assets, including adding a distinct category for reporting cash. The Proposed Amendments also would revise how advisers report portfolio, financing, and investor information. The Proposed Amendments would add a new item concerning the disposition of portfolio securities that would require advisers to report information about the portfolio securities that the liquidity fund sold or disposed of during the reporting period (not including securities that the fund held until maturity). The Proposing Release states that these changes are designed to help the SEC see a more complete picture of the short-term financing markets in which liquidity funds invest, and in turn, enhance the SEC's and FSOC's ability to assess short-term financing markets and facilitate oversight of those markets and their participants.

Conclusion

The enhanced disclosure requirements under the Proposed Amendments are significant in several key areas and underscore the SEC's continued focus on private funds and private fund advisers. We expect that the private fund

[11] A "large liquidity fund adviser" is any adviser managing a liquidity fund and having at least $1 billion in combined regulatory assets under management attributable to liquidity funds and registered money market funds as of the end of any month in the prior fiscal quarter.

[12] *See* Money Market Fund Reforms, Investment Company Act Release No. 34441 (Dec. 15, 2021), available here; *see also* SEC Proposes Amendments to Money Market Fund Rules, Willkie Farr & Gallagher LLP Client Alert (Jan. 11, 2022), available here.

industry will seek to engage with the SEC during the comment period to streamline the proposals and limit the additional requirements.

Comments on the Proposed Amendments must be received within 30 days after the Proposing Release is published in the Federal Register.

If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

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