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Regulatory Alert

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Private Funds: SEC proposed amendments to Form PF

SEC notes that, in the past five years, it has seen significant growth in the numbers of private funds (including funds commonly referred to as hedge funds and private equity funds) and the investment advisers that oversee and/or manage them. Investment advisers' Form PF reporting has shown that the private fund industry is evolving in terms of business practices, complexity of fund structures, and investment strategies and exposures. The proposed "refresh" is intended to fill "significant information gaps" that would help the SEC and FSOC better understand "fast moving market events." Should the Form PF amendments be finalized as proposed, large hedge fund advisers and private equity advisers would face increased reporting requirements. In the near term, given the SEC focus on private funds, SEC-registered investment advisers to private funds should anticipate heightened regulatory attention to their compliance programs in light of the Examinations Risk Alerts that call out fees and expenses, fairness, fiduciary duties, marketing disclosures, and conflicts of interest.

The SEC has proposed amendments to Form PF, a confidential reporting form for investment advisers to private funds. The SEC states the amendments are intended to enhance the ability of the Financial Stability Oversight Council (FSOC) to monitor for activities that may pose systemic risk as well as bolster the SEC's oversight of private fund advisers and strengthen its investor protection efforts.

Proposed amendments to Form PF. As proposed, the changes to Form PF would:

— Introduce a new reporting requirement for large hedge fund advisers and all private equity advisers that would be triggered by the occurrence of certain key events

— Decrease the threshold for reporting as a large private equity adviser from $2 billion to $1.5 billion in private equity fund assets under management

— Require large private equity fund advisers to provide additional information regarding the private equity funds they advise

— Revise how large liquidity fund advisers report information about the liquidity funds they advise

Highlights of these changes follow.

— ***New reporting requirements to be filed upon certain key events***. Large hedge fund advisers and all advisers to private equity funds would be required to file a new "current report" within one business day following certain "trigger" events as outlined in the rule. The SEC notes that these "trigger" events are indicative of significant stress at a fund and could potentially harm investors or signal risk in the broader financial system.

  – *Large hedge fund advisers* would be required to report (through new current reporting section 5) when one of the following events occurs at a qualifying hedge fund they advise: extraordinary investment losses; certain margin events; counterparty defaults; material changes in prime broker relationships; changes in unencumbered cash; operations events; and certain events associated with redemptions.

  - Events would be reportable only if they meet certain objective threshold tests, which would be established in the rule and varied by event type.

- *All advisers to private equity funds* would be required to report (through new current reporting section 6) upon execution of an adviser-led secondary transaction (as defined in the rule); implementation of a general partner or limited partner clawback; or removal of a fund's general partner, termination of a fund's investment period, or termination of a fund.

The SEC adds that large hedge fund advisers currently file form PF on a quarterly basis and private equity advisers file annually. The agency suggests the new requirements would provide the SEC and the FSOC with more timely and detailed information regarding "fast moving events" that could have systemic risk implications or negatively impact investors. No other parts of Form PF would be required to be reported at the time a current report is filed.

— ***Lower reporting threshold for large private equity advisers***. Amendments to Form PF would lower the threshold for reporting as a large private equity adviser from $2 billion to $1.5 billion in private equity fund assets under management. The SEC states that when the $2 billion threshold was established in 2011 it covered 75 percent of the U.S. private equity industry based on committed capital. Currently, this threshold captures approximately 67 percent of the industry; lowering the threshold to $1.5 billion is expected to restore the industry coverage to 75 percent.

— ***New and revised information collection***. Large private equity advisers would also be required to answer new or revised questions in Form PF (in section 4) about the private equity funds they advise, including questions covering the fund's:

- Investment strategies
- Restructurings or recapitalizations
- Investments in different levels of a single portfolio company's capital structure
- Borrowings
- Financings or provision of credit to portfolio companies
- Aggregate borrowings of controlled portfolio companies (CPCs) at fixed and floating rates
- Default events
- Geographical breakdown by country as a percent of net asset value

— ***Revisions to large liquidity fund adviser reporting***. SEC is proposing to require large liquidity fund advisers to report substantially the same information that money market funds would report on Form N-MFP (as recently proposed). SEC states this is intended to provide a "complete picture" of the short-term financing markets. The amendments would revise how large liquidity fund advisers report operational information and assets, as well as portfolio, financing, and investor information. It would also add a new item concerning the disposition of portfolio securities that SEC states is designed to inform the SEC and FSOC of liquidity funds' liquidity management, their secondary market activities in normal and stress periods, and data about how liquidity funds' selling activity relates to broader trends in short-term funding markets.

SEC Examinations Risk Alert. In a separate but related release, the SEC Division of Examinations issued a risk alert outlining compliance issues observed in examinations of registered investment advisers that manage private funds (private fund advisers – SEC notes that more than 5,000 SEC-registered investment advisers are private fund advisers). The Risk Alert highlights four areas of deficiencies:

— Failure to act consistently with material disclosures to clients or investors

— Use of misleading disclosures regarding performance and marketing

— Failure to conduct due diligence relating to investments or service providers, or to follow the due diligence process described to clients or investors

— Use of potentially misleading "hedge clauses."

The Risk Alert supplements an earlier Risk Alert issued in 2020, which highlighted three general areas of deficiencies also identified in examinations of private fund advisers:

— Conflicts of interest

— Fees and expenses

— Policies and procedures to prevent the misuse of material nonpublic information.

In November 2021, Chair Gensler spoke about the need for increased transparency and competition around private funds, specifically calling out fees and expenses, side letters, performance metrics, fiduciary duties and conflicts of interest, and updates to Form PF.

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