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Ms Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549-1090

Submitted via email to rule-comments@sec.gov

March 21, 2022

Dear Ms. Countryman,

Amendments to Form PF to Require Current Reporting and Amend Reporting Requirements for Large Private Equity Advisers and Large Liquidity Fund Advisers (File No. S7-01-22)

The Alternative Investment Management Association Limited (AIMA)[1] and the Alternative Credit Council (ACC)[2] appreciate the opportunity to respond to the U.S. Securities and Exchange Commission's (Commission or SEC) proposed amendments to Form PF to require current reporting and amend reporting requirements for large private equity advisers and large liquidity fund advisers (the "Proposal").[3]

We support the Commission's efforts to monitor, assess and forestall market-wide disruptions in order to prevent a possible build-up of systemic risk and the effects this could potentially have on investors and the wider financial system. AIMA and the ACC have previously provided comments to

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[1] AIMA, the Alternative Investment Management Association, is the global representative of the alternative investment industry, with more than 2,000 corporate members in over 60 countries. AIMA's fund manager members collectively manage more than $2 trillion in assets. AIMA draws upon the expertise and diversity of its membership to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programmes and sound practice guides. AIMA works to raise media and public awareness of the value of the industry. AIMA is committed to developing skills and education standards and is a co-founder of the Chartered Alternative Investment Analyst designation (CAIA) – the first and only specialised educational standard for alternative investment specialists. AIMA is governed by its Council (Board of Directors). For further information, please visit AIMA's website, www.aima.org.

[2] The ACC currently represents over 250 members that manage over $600bn of private credit assets. The ACC is an affiliate of AIMA and is governed by its own board which ultimately reports to the AIMA Council. ACC members provide an important source of funding to the economy, providing finance to mid-market corporates, SMEs, commercial and residential real estate developments, infrastructure as well the trade and receivables business. The ACC's core objectives are to provide direction on policy and regulatory matters, support wider advocacy and educational efforts, and generate industry research with the view to strengthening the sector's sustainability and wider economic and financial benefits.

[3] SEC, Proposing Release, Amendments to Form PF to Require Current Reporting and Amend Reporting Requirements for Large Private Equity Advisers and Large Liquidity Fund Advisers, 87 FR 9106 (Jan. 26, 2022) (the "Proposing Release").

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the Commission seeking to reduce the regulatory burden for filers while strengthening the Commission's and the Financial Stability Oversight Council's (FSOC) monitoring capabilities, especially around the use of leverage via derivatives.

In general, we do not believe that the amendments to Form PF contained in the Proposal will achieve the above stated goals as the information that the Commission wishes to receive will not provide meaningful, market-wide insight into a possible build-up of systemic risk. The data that large hedge fund advisers and private equity advisers will be required to provide is, in our view, not always indicative of potential, significant market stresses. Furthermore, while we agree that the current Form PF could certainly be improved to achieve the Commission's objectives, we do not believe that the proposed amendments are appropriate or justified as they would introduce disproportionate reporting and monitoring burdens and significant stress on the operations and compliance departments of registered investment advisers who are in scope of the Proposal (collectively, "advisers"). The Proposing Release insufficiently elaborates how, and to what extent, the requested data is to be used by the Commission or FSOC, nor has it fully considered the potential negative impacts it would introduce on advisers which we have discussed in more detail below.

To address the concern of having timely market information to monitor for potential systemic risk concerns during periods of market stress, the Commission, and other relevant agencies, should seek additional transaction data from core service providers and counterparties, such as banks, broker-dealers, central counterparty clearing houses, swap data repositories, as well as through the consolidated audit trail. In this way, the Commission and FSOC would have more detailed, timely, consistent and rich data during times of market stress, or even on an *ad hoc* basis, from several significant registrants, rather than through several thousand adviser reports.

Our members have several concerns with the Proposing Release which are outlined in detail in the Annex. In particular, our members note that:

1. the rationale for introducing the proposed amendments is not justified by factual and practical evidence;

2. the cost/benefit analysis is flawed and does not provide an indication of the estimated costs and benefits;

3. the Proposal goes beyond Form PF's original scope and purpose and, in some parts, focuses more on investor protection issues (which should be dealt with elsewhere) rather than the monitoring of systemic risk;

4. the Commission should consider alternative approaches to achieve the objective of receiving timely notification of material events without significantly increasing the operational and reporting burdens for investment advisers;

5. if an alternative approach is not considered viable, the Commission should limit the number of key events and amend the material triggers; and

6. if the Commission adopts the key events as proposed, the one business day reporting period does not provide sufficient time to: (i) gather and confirm the required information for the proposed current reports and (ii) eliminate or significantly reduce false positive reports. Accordingly, the proposed reporting period for current report should be expanded to five business days.

We would be happy to elaborate further on any of the points raised in this letter. For further information please contact Jennifer Wood, Managing Director, Global Head of Asset Management Regulation & Sound Practices, at jwood@aima.org.

Yours sincerely,

Jiří Król
Deputy CEO, Global Head of Government Affairs
AIMA

cc: The Honorable Gary Gensler, Chair
The Honorable Hester M. Peirce, Commissioner
The Honorable Allison Herren Lee, Commissioner
The Honorable Caroline A. Crenshaw, Commissioner

ANNEX A

1. The rationale for introducing the proposed amendments is not justified by factual and practical evidence

In the Proposing Release, the Commission refers to its experiences with "recent market events like the March 2020 COVID-19 turmoil and the January 2021 market volatility in certain stock" which "have highlighted the importance of receiving current information from market participants during fast moving market events"[4] and uses this to justify the Proposal. While we acknowledge that the quoted events were indeed significant, we fully disagree that these crises were caused or amplified by private fund advisers and the Commission has failed to provide the necessary arguments, and data, that would justify the proposed requirements based on those events. Moreover, having analysed and reviewed the Proposing Release in detail, we note that the Commission and FSOC seem to conflate investment and credit risk with systemic risk and, on that basis, introduce the new reporting requirements which, as we discuss below, are not grounded in facts.

Below we have provided an overview of some of the key events that the Proposing Release refers to and which we believe cannot and should not be attributed to advisers and thus debunking the Commission's rationale for introducing the Proposal's amendments.

COVID-19 crisis

During the COVID-19 crisis, the alternative investment industry has shown its resiliency as it has not experienced larger than normal outflows over the period and has rebounded strongly since the market volatility in March 2020 and beyond. We refer to research published and undertaken by SS&C[5] which concluded that redemption notices throughout 2020 were running steadily in the low single digits and the redemption experience was entirely consistent with pre-Covid-19 outbreak levels from 2019 and other recent years. The paper concluded that the 2020 redemption levels did not resemble those of the 2007-08 global financial crisis (the "GFC"). Similarly, the paper also observed that net flows of capital remained remarkably steady in 2020 and was consistent with recent years' data and that, compared to the GFC, current capital flows indicate nothing like the massive outflows that occurred during the GFC.

There were multiple reasons for the restrained outflows offered but it was clear that large hedge fund advisers and private equity advisers seemed to have a better overall risk management framework in this crisis when compared to the frameworks in place at the time of the GFC. Even the most liquid markets such as U.S. Treasury markets experienced severe liquidity issues where traditional intermediaries such as banks were unable to use their own balance sheets to make markets. The reasons for this are multiple but the impact of banking and other regulatory reforms on the ability of

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[4] *Id.* at 9107.

[5] *See* SS&C "Managing fund liquidity in the time of COVID" (Dec. 2020).

traditional intermediaries like banks to make markets in stressed situations is likely among the main causes. The leverage ratio restriction, for instance, is one example of a regulatory constraint that has limited the capacity of intermediaries to provide balance sheet as a 'marketplace'.

In addition, as our research[6] indicates, private credit firms (classed as private credit advisers for the purposes of the Proposing Release) have acted swiftly and significantly in support of the real economy, providing liquidity to stricken companies, amending loan terms and also raising significant amounts of fresh capital to lend into new opportunities or situations where either the banking system or the government support measures were not capable of assisting. The evidence of the truly anti-cyclical nature of the private credit industry has been visible across all major jurisdictions where it operates.

We also refer the Commission to the Financial Stability Report, published by the U.S. Federal Reserve, which concludes the following in relation to the March 2020 Treasury market stress:

> "In sum, the reduction in hedge fund Treasury positions may have contributed notably to Treasury market volatility in mid-March amid a massive repositioning by a wide range of investors. **However, so far, the evidence that large-scale deleveraging of hedge fund Treasury positions was the primary driver of the turmoil remains weak**" (emphasis added).[7]

Archegos collapse

While the Proposing Release makes no direct reference to the collapse of Archegos Capital Management (Archegos) in early 2021, the Commission is in the process of investigating the circumstances that led to the collapse of this family office. In May 2021, Chair Gensler publicly stated that the Commission may consider introducing more stringent disclosure rules for investment firms after the Archegos collapse.[8] In our view, the Proposal can be directly linked to Chair Gensler's comments.

In March 2021, Archegos was forced into a fire sale of securities after some of its portfolio stocks, which it purchased through utilising extreme leverage, witnessed a significant fall. Archegos was unable to meet its prime brokers' calls for more collateral to secure equity swap trades they had partly financed by providing leverage. This prompted a $20 billion fire stock sale as several high-profile banks were forced to sell off Archegos' positions in order to generate cash so that Archegos could pay what was owed.

Archegos was not a private fund adviser. It was a single family office, run by one individual and, as a result, was not subject to Commission oversight or regulation. By being a family office, Archegos was able to avoid the strict post-trade regulatory regime that has impacted private fund advisers. While we understand the Commission's desire to avoid a potential repeat of the Archegos events by

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6 *See* ACC, Financing the Economy 2020 (Nov. 2020).

7 Federal Reserve, Financial Stability Report, at page 35 (Nov. 2020).

8 *See* Chair Gensler, Testimony Before the House Committee on Financial Services (May 6, 2022).

introducing preventive measures, such as through its recent rule proposal on security-based swaps[9] or requiring private fund advisers to provide near real-time reporting as set out in the Proposal, leverage plays an important role in the alternative investment fund industry and the wider financial markets and is a structural part of some investment strategies. We note that the only public study carried out to date was based on the regulatory data gathered from a sample of alternative investment funds and shows that there is a negative correlation between risk and leverage (measured using multiple metrics).[10]

While we acknowledge that the Commission has not put forward restrictions or conditions on the use of leverage in the Proposing Release, reference is made to an excessive use of leverage by large hedge fund advisers which could prompt them to file a current report. For example, with respect to the proposed "Significant Margin and Default Events" reporting event, the Proposing Release notes that "[s]udden and significant margin increases can have critical effects on funds that may be operating with large amounts of leverage and could serve as precursors to defaults at fund counterparties and eventual liquidation."[11] In addition, the Proposing Release states that "large hedge funds that use leverage through loans, derivatives, or repurchase agreements with other financial institutions as counterparties may cause significant problems at those financial institutions in times of stress"[12] and cites an outdated report,[13] published in 2010. Moreover, the Proposing Release also refers to the use of leverage, and its potential to increase systemic risk, in the amendments related to private equity fund advisers where it states that "private equity funds' increasingly extensive use of leverage for financing portfolio companies and a significant increase in the use of private credit strategies both raise systemic risk concerns."[14]

In a recent press release issued by FSOC, explicit reference is made to the Archegos collapse where it refers to its Hedge Fund Working Group which found "that the failure of Archegos Capital Management – **a family office employing leveraged strategies also used by hedge funds** – transmitted material stress to large, interconnected financial institutions" (emphasis added).[15] While the Hedge Fund Working Group acknowledges that Archegos was indeed a family office, it strongly implies that a similar collapse, and subsequent market disruptions, of a hedge fund adviser may naturally occur. As noted above, family offices are not subject to Commission oversight or regulation and the circumstances surrounding Archegos' collapse were unique and cannot be attributed to hedge fund advisers. In comparison to family offices, hedge fund advisers are subject to Commission oversight,

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9 SEC, Proposing Release, Prohibition Against Fraud, Manipulation, or Deception in Connection With Security-Based Swaps; Prohibition Against Undue Influence Over Chief Compliance Officers; Position Reporting of Large Security-Based Swap Positions, 87 FR 6652 (Feb. 4, 2022).

10 Daniel Barth, Laurel Hammond and Phillip Monin from the Office of Financial Research of the U.S. Treasury (OFR), Leverage and Risk in Hedge Funds, OFR Working Paper 20-02 (Feb. 25, 2020) (the "OFR Working Paper").

11 Proposing Release, *supra* note 3, at 9111.

12 *Id*. at 9130.

13 Proposing Release, *supra* note 3, footnote 160.

14 Proposing Release, *supra* note 3, at 9128.

15 U.S. Department of the Treasury, Financial Stability Oversight Council Statement on Nonbank Financial Intermediation (Feb. 4, 2022).

and are required to comply with strict operational standards and organisational requirements such as conflicts of interest and conduct rules, protection of client assets as well as prudential regulations on liquidity and risk management.

We refer the Commission to an independent external investigation, commissioned by Credit Suisse, into the collapse of Archegos.[16] As the Commission is aware, Credit Suisse's prime services business provided financing (i.e., leverage) to Archegos, eventually resulting in a multimillion dollar loss for Credit Suisse. The report concludes that:

> "The Archegos-related losses sustained by CS [Credit Suisse] are the result of a fundamental failure of management and controls in CS's Investment Bank and, specifically, in its Prime Services business. The business was focused on maximizing short-term profits and failed to rein in and, indeed, enabled Archegos's voracious risk-taking. There were numerous warning signals—including large, persistent limit breaches—indicating that Archegos's concentrated, volatile, and severely under-margined swap positions posed potentially catastrophic risk to CS. Yet the business, from the in-business risk managers to the Global Head of Equities, as well as the risk function, failed to heed these signs, despite evidence that some individuals did raise concerns appropriately.
>
> The Archegos default exposed several significant deficiencies in CS's risk culture, revealing a Prime Services business with a lackadaisical attitude towards risk and risk discipline; a lack of accountability for risk failures; risk systems that identified acute risks, which were systematically ignored by business and risk personnel; and a cultural unwillingness to engage in challenging discussions or to escalate matters posing grave economic and reputational risk. The Archegos matter directly calls into question the competence of the business and risk personnel who had all the information necessary to appreciate the magnitude and urgency of the Archegos risks, but failed at multiple junctures to take decisive and urgent action to address them."[17]

Credit Suisse's report is further evidence that the circumstances surrounding Archegos' collapse were unique, amplified by a prime broker who did not follow normal and widely accepted risk management standards and should therefore not be ascribed to hedge funds.

We note that the Proposing Release does not cite any recent studies or academic papers, such as the 2020 OFR Working Paper which reviewed the most comprehensive hedge fund data provided under the Form PF reporting requirements. The authors of the OFR Working Paper put forward the following conclusion:

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[16] *See*, Credit Suisse, Group Special Committee of the Board of Directors Report on Archegos Capital Management (Jul. 29, 2021).

[17] *Id.* at pages 1-2.

> "The use of leverage is often considered a key potential systemic risk in hedge funds. Yet, data limitations have made empirical analyses of hedge fund leverage difficult. Traditional theories predict leverage and portfolio risk are positively linearly related. Alternatively, an emerging wave of theories of leverage constraints predict leverage and asset risk are negatively correlated, and therefore leverage and portfolio risk may be unrelated or even negatively related. **Consistent with theories of leverage constraints, we find that hedge fund leverage and portfolio risk are weakly negatively correlated**" (emphasis added).[18]

Leveraged lending in the private credit industry

We also disagree with the assumption made by the Commission and FSOC that leverage, or leveraged lending in the private equity and private credit industry, could be directly contribute to systemic risk. In addition to the OFR Working Paper above, we refer the Commission to a report by the U.S. Government Accountability Office (GAO) published in December 2020 which stated that, "[a]lthough regulators monitoring the effects of the pandemic [i.e., COVID-19] remain cautious, as of September 2020, they had not found that leveraged lending presented significant threats to financial stability."[19] Furthermore, GAO concludes that "leveraged lending activities generally have not posed significant threats to the stability of the U.S. financial system."[20] Finally, with regards to the Commission's statement that private equity funds' use of leverage and the use of private credit strategies raises systemic risk concerns,[21] the Proposing Release, in footnote 135, cites an article in the Financial Times[22] on a report by Moody's, published in October 2021, which we believe is more speculative than informative. The actual observations of that report do not match the Commission's conclusion, as Moody's notes that

> "[s]ome structures that facilitate the expansion of direct lending have stronger financial disclosure and credit quality, including BSLs, CLOs and BDCs. The vehicles balance these risks through portfolio diversity and stronger creditor protections in loan agreements than for institutional loans, among other risk mitigants (Exhibit 4). In addition, asset managers' financial and managerial sophistication help balance the operating and financial risks of the middle-market companies that make up direct lending portfolios."[23]

The Moody's report argues that rising leverage increases downside risk and that, compared to banks, the private credit industry is more tolerant of borrowers who employ high leverage and/or highly

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18 OFR Working Paper, *supra* note 10.

19 United States Government Accountability Office, Financial Stability – Agencies Have Not Found Leveraged Lending to Significantly Threaten Stability but Remain Cautious Amid Pandemic (Dec. 2020).

20 *Id.* at page 32.

21 Proposing Release, *supra* note 3, at 9128.

22 *See* Moody's Warns of 'Systemic Risks' in Private Credit Industry, Financial Times (Oct. 26, 2021).

23 *See* Moody's Investors Service, As private credit continues to grow, risks are getting swept into grey zone, page 5 (Oct. 25, 2021) (the "Moody's report").

leveraged deals. It is important to address the assumptions underpinning this analysis. We would first stress to the Commission that leverage at the fund level should be distinguished from portfolio company leverage.

The majority of private credit funds operate with either no or modest levels of leverage[24] and employ policies to manage and monitor the use of leverage within their investment strategy. These policies are designed to work in a range of scenarios. Furthermore, private credit funds employ a combination of liquidity management tools to prevent potential liquidity mismatches arising in the event of investors seeking to redeem their capital. These might include but are not limited to:

- lock-up periods which prevent redemptions before a pre-determined period;
- prescribed redemption windows (e.g., semi-annual or annual);
- ex-ante investor level gates which allow only a small portion (10-20%) of investor capital to be redeemable during any redemption periods; and
- lengthy notice periods for redemption requests (e.g., 90 -180+ days).

We would also highlight how the use of leverage is also prescribed by a combination of investor requirements and the commercial terms set by finance providers. Investors have significant transparency on how leverage might be employed by the investment manager as part of their due diligence process prior to investing. This will include any appropriate leverage limits, risk management systems, the source of financing as well as the collateral required. Leverage providers, typically banks but also some pension funds or insurers, will also undertake their own analysis before providing financing to private credit funds. Their risk appetite therefore plays a significant role in determining the availability of leverage for private credit funds.

Despite several periods of stress during the past 15 years of growth for the sector there have been no systemic issues arising from the use of leverage by private credit funds. Should the SEC have concerns with respect to the use of leverage, potential liquidity mismatches and systemic risk, then this should be addressed on a consistent basis to maintain a level playing field across different types of funds.

With respect to the levels of leverage at the level of portfolio companies and the assumption that this may exacerbate downside risk, we would highlight that the GAO report did not consider that leveraged lending by private credit funds significantly threatened financial stability.

Levels of debt are an important component of the credit analysis, due diligence and underwriting done by private credit managers on firms they invest in, but they are not the only consideration when assessing creditworthiness and whether the investment is in line with the investment mandate. Borrowers with higher levels of debt clearly present different risks to those with lower levels of debt but this does by itself does not make them either inherently more risky or more likely to lead to stress.

[24] *See* ACC, Financing the Economy 2018, Figure 43 (Nov. 2018).

Credit fund managers will employ rigorous underwriting and due diligence prior to granting a loan to these entities and will have other measures in place to mitigate downside risk. As part of their existing due diligence processes, investors benefit from substantial levels of transparency about the credit underwriting, due diligence, risk management and restructuring capabilities of private credit fund managers prior to making any investment.

For these reasons, we do not believe that the Moody's analysis is an appropriate evidence base to determine the Commission's policy towards private credit funds. If the SEC believes that there are issues which warrant further rulemaking, this should be established through a dedicated study that would allow a more comprehensive consideration of current market practices and whether there are risks which needs to be managed through SEC rulemaking.

Finally, the Proposing Release implies that private equity funds and their advisers use their credit arms to provide financing for their private equity transactions which is wholly inaccurate. Many of our members operating in the private equity and private credit industry have expanded their credit arms significantly as a result of the outgrowth of increased demand for private credit, in turn a direct result of the dramatic growth in the private equity industry. However, if a firm were exposed on both a private equity investment and private credit investment in the same issuer and the issuer were to go bankrupt, the firm would have two parts of its business in conflict with each other since their interests are not aligned. This acts as a natural limitation on firms using their private credit arm to finance their private equity transactions and is something that is heavily scrutinised by investors. Although the majority of private credit financing may go to private equity sponsored firms, those private equity sponsors are usually unrelated.

Data collection and analysis need to be improved to justify the reporting requirements

We believe that before any potential, drastic changes to the use and measurement of leverage are introduced, the Commission should refine its data collection and take several necessary empirical and analytical steps as this could otherwise have the potential to result in damaging limitations to investment management. While this may then achieve the reduction of leverage, this would not necessarily improve financial stability, investor protection or the orderly functioning of markets. We do not claim that the use of leverage is always divorced from micro- or macro-level risk, but we wish to point out that, in sophisticated investment strategies, the link between leverage and risk is likely to be nuanced and counterintuitive. This is due to the fact that most strategies that use leverage will do so to manage, reduce or transform risk in a manner that is not consistent with a less sophisticated deployment of leverage in other sectors of the financial market.

We again stress that there is no policy justification for the proposed amendments which would seek to impose unnecessary and disproportionate compliance and operational burdens on advisers. The Commission has not presented any evidence in the Proposing Release elaborating on the negative role that private fund advisers supposedly played during the COVID-19 crisis or the Archegos collapse. As mentioned above, and evidenced by various studies and market data, private fund advisers did not

cause or amplify these crises and so the Commission's justification for introducing the reporting requirements is not premised on factual evidence.

Reporting of key events could exacerbate a crisis

While the current reports are not proposed to be made public by the Commission, we note there is a realistic possibility that (i) the reports are leaked into the public domain, (ii) if leaked into the public domain, the reports could spur uncontrollable rumours and far-reaching, negative industry reactions, and/or (iii) investors will demand to receive these reports even if not leaked. Since the reports are due within one business day, there is a realistic probability that the event that triggered the report is still ongoing and decisions will not have been made about the cause, nature, impact or remediation of the event at the time the event is reported. This could exacerbate a crisis that the adviser is dealing with or could potentially start a crisis where previously there was none taking into consideration the arbitrary material triggers behind some of the key events. Focus of the critical staff who are assessing and remediating the triggering event will be diverted to instead deal with investor demands for information or potential interventions from the Commission. Moreover, investors may inquire about the occurrence of the proposed key events in their annual due diligence questionnaires and during their pre-investment due diligence on the large hedge fund adviser. As we have outlined further below, several of the key events are not indicative of systemic risk and the quantitative thresholds that would trigger a reporting requirement would result in many 'false positives' but would reasonably be expected to be disclosed to the investor during the pre-investment and annual due diligence questionnaires. By disclosing these events, the majority of which will not be material or indicative of systemic risk, investors may resort taking drastic and far-reaching measures, thereby exacerbating a 'crisis' that the adviser is dealing with or could potentially start a crisis where previously there was none.

2. The cost/benefit analysis is flawed and does not provide an indication of the estimated costs and benefits

Considering the impact of the reporting requirements on advisers' resources, the Commission's cost/benefit analysis fails to provide a meaningful indication of the costs associated with complying with the proposed requirements other than perhaps the cost of filing in the form.

Concerns with the economic analysis

We believe the economic analysis falls short in establishing a baseline of current practices and assessing the costs and benefits of the Proposing Release in a thorough and impartial manner.[25]

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[25] *See* SEC "Current Guidance on Economic Analysis in SEC Rulemakings, Memorandum" (March 6, 2012), available at https://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf (identifying the elements as follows: "(1) a statement of the need for the proposed action; (2) the definition of a baseline against which to measure the likely economic consequences of the proposed regulation; (3) the identification of alternative regulatory approaches; and (4) an

Furthermore, in the Proposing Release, the Commission notes that it "also considered an alternative to require hedge fund and private equity advisers to file current reports within a time period longer than one business day."[26] However, it does not provide or discuss the alternative that was considered but only mentions that "[a]lthough this alternative would provide more time to advisers to prepare and file the form, we do not anticipate that this would reduce the cost burden to advisers as compared to the one-day reporting requirement."[27] While we would agree this would perhaps not reduce the reporting cost, it would certainly reduce the wider reporting burden and so we would request the Commission, as per our request further below, to extend the reporting requirement period to five business days after the adviser has become aware that a reporting event has occurred.

A possible alternative which the Commission could have, or perhaps has considered but not referenced in the Proposing Release, is the reporting requirements imposed by the NFA through Compliance Rule 2-50 on CPO Notice Filing Requirements (see below). Alignment with the NFA would impose substantially lower compliance costs since dual registrants (i.e., Commission and NFA registrants) already have to comply with NFA Rules. In addition, the approach adopted by the NFA does not include measures which are not tracked in the normal course of an adviser's business and which do not require one-off operationalisation to gather the necessary data to prove the adviser stands ready to report when it needs to and that on the days it did not report, none of the material triggers were met.

Moreover, the Proposing Release does not discuss, or let alone expand, on the rational and evaluation of the material triggers behind the key reporting events which appear to be wholly arbitrary and is further evidence that the Commission has not provided the robust analysis that is needed to justify the proposed requirements. Further below we provide detailed comments to the proposed material triggers underlying the key events.

Assessing costs of the Proposal

As the Commission acknowledges in the Proposing Release, "The proposed amendments to Form PF would lead to certain additional costs for private fund advisers. Any portion of these costs that is not borne by advisers would ultimately be passed on to private funds' investors."[28] In Section C of the Proposing Release ("Benefits and Costs"), the Commission describes, very briefly, that it expects the direct costs associated with the one business day reporting requirement, to "include initial costs required to set up a system for monitoring significant events that are subject to the current reporting requirement as well as filing fees."[29] We note that these filing fees will be determined by the Commission in a later, but separate action,[30] which we believe is another indication of a flawed

evaluation of the benefits and costs—both quantitative and qualitative—of the proposed action and the main alternatives identified by the analysis.").

26 Proposing Release, *supra* note 3, at 9136.

27 *Ibid.*

28 *Id.* at 9134.

29 *Id.* at 9135.

30 *Ibid.*

cost/benefit analysis as the filing fee associated with the proposed amendments is an important aspect of the Proposing Release and would demonstrate the expected costs that advisers will need to reserve and which will, ultimately, be borne by their investors. Advisers should be made aware of these costs ahead of the Proposing Release's (potential) adoption, not after the Commission may have voted in favour of the amendments.

In addition, the Commission has not given sufficient consideration to the associated direct and indirect costs, including the initial set-up costs, external costs and subsequent costs of the Proposing Release. On the initial costs, the Commission merely notes that it anticipates the initial costs "to be limited because the current report triggers were tailored and designed not to be overly burdensome."[31] On the indirect costs, such as external costs, the Proposing Release notes that the "proposed amendments provide an incentive for advisers to improve internal controls and devote additional time and resources to managing their risk exposures and enhancing investor protection, this may result in **additional expenses** for advisers, some of which may be passed on to the funds and their investors" (emphasis added).[32] Finally, on the subsequent costs, the Commission states that this "would depend on the occurrence of the reporting events and frequency with which those events occur."[33]

The Economic Analysis should include a thorough and impartial analysis of the potential costs and benefits of the proposed current reporting requirements to affected advisers. As per the quoted text above, the Economic Analysis offers little beyond a generalised assessment of the costs. It provides no evidence of how many current reports it expects would need to be filed, nor does it attempt to provide an estimate of that number. The Proposing Release is unable to demonstrate the materiality or lack thereof, of the costs involved and fails to quantify the costs associated with the one-time set-up of the advisers' compliance controls necessary to gather the relevant data on a daily basis in order for the adviser to demonstrate that it did not need to file a current report by the next business day.

Finally, and as discussed above, the Commission has failed to provide stakeholders with a convincing justification of why it proposes the reporting requirements or the benefits that it would achieve. The Proposing Release states that the "proposed current reporting requirement would improve the transparency to the Commission and FSOC of hedge fund activities and risk exposures, which would enhance systemic risk assessment and investor protection efforts."[34] It further notes that "current reports would be especially useful during periods of market volatility and stress, when the Commission and FSOC are actively and quickly ascertaining the affected funds, gathering information to assess systemic risk, and determining whether and how to pursue regulatory responses, and when the Commission is actively determining whether and how to pursue outreach, examinations, or investigations."[35] While we understand these goals, we respectfully submit that asking for real-time,

[31] *Ibid.*
[32] *Ibid.*
[33] *Ibid.*
[34] *Id.* at 9130.
[35] *Ibid.*

ex-ante information in a manner that will impose significant operational and compliance burdens on private fund advisers is not justified by the desire to have such information for ex-post outreach, examinations or investigations and that submissions of this information on a longer deadline would not affect the value of the information for those purposes. We ask the Commission to consider (i) adopting a more streamlined current reporting approach, like the one the NFA is taking under its Compliance Rule 2-50 (please see below), or (ii) extending the reporting deadline to at least five business days (also below).

3. The Commission goes beyond Form PF's original scope and purpose

The proposed amendments would fundamentally alter the nature of Form PF, changing it from a quarterly or annual filing made in connection with a regular compliance cycle to a current report that needs to be quickly refiled on the occurrence of certain events which would, in essence, turn into an obligation to start tracking information required for certain Form PF data fields on a daily basis. It also potentially changes how the Commission would use Form PF.

Form PF's original purpose

In her dissenting statement on the Proposing Release, Commissioner Hester M. Peirce noted that at the time of Form PF's adoption in 2011, "Congress did not conceive of Form PF to facilitate the Commission's desire to inoculate well-heeled investors against downturns, losses, or fund failures."[36] Commissioner Peirce further stated that the proposed changes represents "a fundamental shift in the Form PF's scope and purpose" and that "requiring almost immediate reporting of localized events would distend Form PF into a tool for government to micromanage private fund risk management."[37] We agree with her assessment.

When the Commission and the Commodity Futures Trading Commission (CFTC) adopted the joint final rules[38] on Form PF in 2011 in order to implement sections 404 and 406 of Dodd-Frank,[39] the objective of the current Form PF was to "provide FSOC and the Commissions [CFTC and the Commission] with important information about the basic operations and strategies of private funds and help establish a baseline picture of potential systemic risk in the private fund industry."[40] The Commission adopted new Rule 204(b)-1 under the Investment Advisers Act of 1940, as amended, and Form PF to enable FSOC to obtain data that would facilitate monitoring of systemic risk in U.S. financial markets.

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[36] Commissioner Hester M. Peirce, Statement on Proposed Amendments to Form PF to Require Current Reporting and Amend Reporting Requirements for Large Private Equity Advisers and Large Liquidity Fund Advisers (Jan. 26, 2022).

[37] *Ibid.*

[38] *See* SEC/CFTC, Joint Final Rules, Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF, 76 FR 71127 (Nov. 16, 2011) ("Form PF Adopting Release").

[39] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act (Jul. 21, 2010) ("Dodd-Frank").

[40] Form PF Adopting Release, *supra* note 38, at 71129.

Under Section 404(3) of Dodd-Frank, Congress mandated the Commission to collect the following information from registered investment advisers:

> "(3) REQUIRED INFORMATION.—The records and reports required to be maintained by an investment adviser and subject to inspection by the Commission under this subsection shall include, for each private fund advised by the investment adviser, a description of—
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> "(A) the amount of assets under management and use of leverage, including off-balance-sheet leverage;
>
> "(B) counterparty credit risk exposure;
>
> "(C) trading and investment positions; "
>
> (D) valuation policies and practices of the fund;
>
> "(E) types of assets held;
>
> "(F) side arrangements or side letters, whereby certain investors in a fund obtain more favorable rights or entitlements than other investors;
>
> "(G) trading practices; and
>
> "(H) such other information as the Commission, in consultation with the Council [i.e., FSOC], determines is necessary and appropriate in the public interest and for the protection of investors or for the assessment of systemic risk, which may include the establishment of different reporting requirements for different classes of fund advisers, based on the type or size of private fund being advised."[41]

The breadth of the new reporting requirements goes beyond Congress' mandate under Dodd-Frank and the current Form PF Rule's stated objectives and captures smaller investment advisers and routine investment activity that appear purely to foster the Commission's more general objectives – data collection to support examinations, and its regulatory and enforcement programmes relating to exempt reporting advisers. The key events that the Commission wants advisers to file a report on if the pre-determined material thresholds are triggered are, in our view, not all indicative of systemic risk and strong market disruption. Further below we have outlined our views on the proposed reporting events and how we believe these are not all indicative of systemic risk or that they will achieve the Commission's objective of improving investor protection.

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[41] *See* Dodd-Frank, *supra* note 39.

4. **The Commission should consider alternative approaches such as the approach taken in NFA Compliance Rule 2-50**

If the Commission adopts amendments to Form PF, we strongly urge the Commission to consider taking an approach similar to what the National Futures Association (NFA) has done in NFA Compliance Rule 2-50 ("NFA Rule 2-50") and the related Interpretive Notice,[42] which require commodity pool operators ("CPOs") that are NFA members to file reports if certain key events which could have systemic implications (e.g., risk of fire sales and counterparty exposure) occur and which we believe are more indicative of systemic risk than most of the events identified in the Proposal.

NFA Rule 2-50 requires CPOs to notify the NFA of the occurrence of one or more identified reporting events. Reporting is required promptly (interpreted as the next business day) if the CPO:

(a) operates a commodity pool that is unable to meet a margin call(s);

(b) operates a commodity pool that is unable to satisfy redemption requests in accordance with its subscription agreements;

(c) operates a commodity pool that has halted redemptions and the halt on redemptions is not associated with pre-existing gates or lockups, or a pre-planned cessation of operations; or

(d) receives notice from a swap counterparty that a pool the CPO operates is in default.

NFA Rule 2-50 and the related Interpretive Notice,[43] which were adopted with effect from June 30, 2021, provide guidance that more fully clarifies the circumstances that require notice and limits the scope for reporting in non-critical circumstances. Where the NFA is requiring CPOs to notify them of the occurrence of four key events that have binary triggers, the Commission, under the Proposal, would require large hedge fund advisers to report a total of seven key events and private equity advisers on three key events, some with quite complex triggers. NFA Rule 2-50's key events set out the basic principles without introducing arbitrary thresholds as set under the Proposal's key events. If the Commission wishes to gather information on systemic risk trigger events, in consultation with FSOC as suggested in section 404(3)(H) of Dodd-Frank, we believe that the Commission should consider requiring private fund advisers to report on the key events as set out under NFA Rule 2-50 which would substantially reduce advisers' compliance burdens, in particular for those advisers who are dual registrants, while still providing the Commission the type of real-time information of material events that the Proposal appears to be seeking. This would also provide FSOC with directly comparable information from similarly situated firms.

[42] *See* Interpretive Notice 9080 – NFA Compliance Rule 2-50: CPO Notice Filing Requirements (Feb. 18, 2021).
[43] *Ibid*.

5. If an alternative approach is not considered viable, the Commission should limit the number of key events and amend the material triggers

According to the Proposing Release[44] and FSOC,[45] the two key transmission channels, or the mechanisms through which stress can be passed on from hedge funds to other parts of the financial sector, are fire sales and counterparty exposure. On the former, FSOC states that if a large, highly levered hedge fund were to undergo significant stress, it may have to resort to asset fire sales to raise cash to meet its obligations. On the latter, large hedge funds using leverage provided by prime brokers may cause significant problems at these institutions in times of stress. If this is indeed still FSOC's views, and we are not aware of any more recent or relevant discussions showing otherwise, the key events that large hedge fund advisers would need to report on go well beyond capturing data on contagion from fire sales of assets or losses at prime brokers. If the Commission wishes to pre-empt and/or mitigate these two 'key transmission channels', we believe that there are only a handful of the key reporting events proposed that large hedge fund advisers should report on. These are:

(a) fund margin default or inability to meet a call for margin, collateral, or an equivalent (i.e., Section 5, Item D); and

(b) fund is unable to satisfy redemptions or suspensions of redemptions (i.e., Section 5, Item J).

We believe that these events are more symptomatic of significant distress which could potentially lead to counterparty losses. The other key reporting events for large hedge fund advisers should not be incorporated into Form PF as these are all ancillary to the key events listed above and will only be of relevance if their occurrence results in a severe loss by the hedge fund advised by the adviser. For example, a requirement to report on an operational event (as per Item H), would only be relevant if this would result in extraordinary investment losses (as per Item B), and an extraordinary investment loss is only relevant if it leads to being unable to satisfy redemptions in accordance with the fund's terms or a suspension. In addition, a significant decline in unencumbered cash (as per Item G), a significant increase in margin (as per Item C), or a failure of a counterparty to meet a call for margin (as per Item E) would, again, only be of material relevance if this would result in a severe loss such that it leads to being unable to satisfy redemptions in accordance with the fund's terms or a suspension.

None of the private equity adviser key reporting events appear to address any identified area of potential systemic risk and, as such, we believe they should all be omitted from the final requirements.

Amend material triggers of key events

As mentioned, we do not support the inclusion of the majority of the key events identified by the Commission. If, however, the Commission chooses to adopt them in full or limit them to the types of

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44 Proposing Release, *supra* note 3, at 9130.

45 *See* FSOC, Update on Review of Asset Management Products and Activities (Apr. 18, 2016) (the 'FSOC paper').

events identified above, we believe that the material triggers should be narrowed or reconsidered to limit the occurrence of 'false positives' as much as possible.

In general, however, we note that the material thresholds set by the Commission are wholly arbitrary and the Proposing Release does not provide a satisfactory or comprehensive elaboration as to why the Commission has arrived at these particular thresholds, and in some cases provides no indication how the triggers are meant to be calculated in the first instance.

We refer, again, to NFA Rule 2-50's key events which we note do not contain quantitative thresholds. CPOs are required to notify the NFA if a commodity pool (i) is unable to meet a margin call; (ii) unable to satisfy redemption requests; (iii) halts redemptions; and (iv) is declared in default by a swap counterparty. CPOs would be required to notify the NFA upon any breach – depending on certain, specified and mitigating circumstances. These events offer only a binary interpretation, i.e., a pool is able or unable to meet a margin call or is able or unable to satisfy redemption requests. We believe that by replicating NFA Rule 2-50's key events and the omission of any material thresholds would be a more proportionate and appropriate approach for advisers. Advisers will then not be required to track the information on a continuous basis which would greatly reduce operational and compliance burdens. The Proposal addresses these matters on Items D and J of the new part 5 of Form PF.

If, however, the Commission decides to proceed with the proposed key events for advisers, we have outlined our views on each key event and how these should be amended below.

Generally, we do not understand how and why the Commission has arrived at the thresholds chosen. On what basis has it not opted for a higher or lower threshold? The Proposing Release notes, without supporting analysis or cost estimates, that:

> "…alternative triggers to current reporting requirements would either provide the Commission and FSOC with more information at a greater cost to advisers, less information at a lower cost to advisers, or an alternative metric for measuring the same stress event as the proposed reporting event. We believe that the thresholds as proposed would trigger reporting for relevant stress events for which we seek timely information while minimizing the potential for false positives and multiple unnecessary current reports…."

As noted above, "the potential for false positives and multiple unnecessary current reports" is built into the triggers built on the fund's most recent NAV reported on Form PF and no analysis of the false negatives or false positives associated with any option are presented, much less analysed for which option could potentially minimise these.

We note that included in all of the reporting events outlined above is an explanatory checkbox where advisers can provide additional information around the circumstances that triggered the reporting. While this is certainly helpful, this raises the point that the manner with which the Commission has

defined the events and the material triggers behind them may not be necessarily indicative of a negative and potentially damaging event and that these triggers should be altered.

Similarly, no analysis of the costs associated with the percentage thresholds selected versus any other possible threshold is presented. All this suggests that the thresholds chosen are arbitrary and capricious. In the cost-benefit analysis, the Commission states: "We anticipate these initial costs to be limited because the current report triggers were tailored and designed not to be overly burdensome and to ***allow advisers to use existing risk management frameworks that they already maintain to actively assess and manage risk***" (emphasis added). No hedge fund adviser is currently tracking anything specifically against the NAV reported on its last Form PF filing. This is simply not part of anyone's "existing risk management framework".[46] All of the requirements tied to the fund's most recent NAV reported on Form PF will require tracking to be built from scratch.

The Proposing Release goes on to posit that "subsequent compliance costs would depend on the occurrence of the reporting events and frequency with which those events occur."[47] While this is true as relates to the actual cost of preparing the filing, the more significant subsequent costs are the daily calculations that have to be done, especially with respect to highly subjective considerations like the ones proposed in the operations event trigger.

Large hedge fund adviser key events

Our specific concerns with respect to each of the key events for large hedge fund advisers are set out below:

- <u>Extraordinary investment losses</u>: The Proposing Release states that "[r]eporting for proposed Item B would be triggered by a loss equal to or greater than 20 percent of a fund's most recent net asset value over a rolling 10 business day period."[48] The Commission argues that "[i]n our experience, losses of 20 percent or more of a fund's most recent net asset value during this period could indicate significant stress at the fund or the markets in which the fund participates that could raise investor protection and systemic risk concerns warranting prompt reporting."[49] However, the Proposing Release does not elaborate on its "experience" nor does it provide robust data or examples of hedge funds experiencing equal or greater losses than 20% of the fund's most NAV reported on Form PF that would justify inclusion of the quantitative threshold or that, if reported within one business day would have allowed the Commission to intervene to avoid a subsequent systemic event. We also note that the 20% loss calculation does not appear to consider the effects of subscriptions and redemptions on NAV which can then skew the data the Commission is receiving in its assessment of possible systemic risk.

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46 Proposing Release, *supra* note 3, at 9135.
47 *Ibid.*
48 Proposing Release, *supra* note 3, at 9109.
49 *Id.* at 9110.

Unless the extraordinary investment losses are sufficient to trigger a suspension or cause the fund to be unable to meet redemption requests in accordance with the fund's terms, which might then cause a fire sale of the fund's remaining assets, the investment losses should not be the concern of the Commission. Investment losses, even large ones, are a business as usual risk for funds and it is not the purpose of the Commission to protect investors from investment losses by intervening in the investment adviser's management of the fund, which would presumably be the result of the current report. Investment funds should be allowed to fail in the normal course without Commission intervention. If, however, the Commission believes that intervention in large hedge fund adviser's management of the fund is to become its purpose, how will it meaningfully intervene and/or protect investors once these losses have occurred? For these reasons, this triggering event should be deleted. In addition, some strategies are, by design, more volatile than others. This is either because they operate in more volatile markets or because they are purposefully using techniques that may increase their volatility in the normal course of business. Having a single 20% threshold is therefore not reflective of the differences in underlying strategies and markets.

The absolute 20% threshold also does not appear to make much sense for times when markets overall may exhibit higher than normal volatility. In such times, the Commission, indeed the entire market, will be aware that higher losses are likely to be more frequent across a whole range of actors but that may simply be reflective of the general economic conditions. The Commission would then receive a multitude of reports, most of which would have little empirical value for the purposes of assessing systemic risk.

Moreover, there will be a number of instances where liquidity of the underlying instruments and hence the ability to value them accurately may be significantly diminished. In such situations, it is not uncommon for funds to have divergent outcomes of instrument valuation. In addition, their financing counterparties may also have different views as to the value of the financed collateral, leading to potential disputes that may take time to resolve. All of this would increase the operational burden in attempting to satisfy the new regulatory obligations and result in potentially inconsistent outcomes.

Finally, if the Commission is of the opinion that Item B should remain, and taking into account the above, we respectfully ask that the quantitative threshold would be triggered only by a loss equal to or greater than 50% (instead of 20%) of a fund's most recent NAV over a rolling 10 business day period.

- Margin, collateral or equivalent increase: Under proposed reporting Item C, large hedge fund advisers would be required to report significant increases in the reporting fund's requirements for margin, collateral, or an equivalent. This significant increase is triggered if the reporting fund experiences a cumulative increase in margin of more than 20% of the fund's most recent NAV reported on Form PF over a rolling 10 business day period. We note that it is very common for hedge fund advisers to routinely increase, or decrease, leverage on a tactical basis within the fund,

and in keeping with good operational controls and practices, hedge fund advisers will withdraw collateral at counterparties if this is not needed at those counterparties and will redeploy the collateral when necessary. We note that this is a common feature of hedge funds' strategies and business as usual operations. As a result, we do not believe that a 20% increase in margin, collateral or the equivalent is necessary or reflective of stress and false positive reports are very likely to occur on a regular basis.

Setting the threshold such that items not indicating significant stress are anticipated, such as where the fund is establishing a new relationship or new business with one or more counterparties or the increase is attributable to new investment positions, investment approach or strategy and/or portfolio turnover of the reporting fund, imposes costs for no benefit. There should be an ex-ante carve out for these items and instructions not to make a filing at all if the trigger threshold is met for these reasons.

As long as the fund is still able to make margin calls and is not in default, the increases on collateral should not be considered systemically relevant. We suggest that this event trigger should be deleted in favour of a requirement for a notice filing once the large hedge fund adviser has determined that the fund is unable to meet a margin call within the relevant cure period or the large hedge fund adviser has received a notification that the fund is in default to a swap counterparty on a margin call, resulting in a deficit that the fund will not be able to cover or address by adding additional fund within the cure period. These are covered in Item D.

In addition, we again question the Commission's justification of the threshold as it states that "[w]e believe that a 20 percent increase to a fund's margin requirements over a 10 business day period is large enough and precipitous enough to signal potential significant stress at the fund, at its counterparties, or in the broader market while limiting the potential for reporting in the case of routine margin increases." [50] As with Item B above, why has the Commission chosen this particular threshold? Why has it not opted for a higher or lower threshold? No analysis of other potential options is provided.

Form PF as proposed does not define "margin" so it is not clear in this provision whether this means initial margin and/or variation margin. Moreover, we note that the term "collateral" has also not been adequately defined for purposes of this section and should be clearly defined to only include the "margin equivalent" figure with respect to financing arrangements (e.g., limited to the "haircut" amount for repurchase agreements and the net risk margin required for the prime broker) rather than the gross value of all collateral posted pursuant to those relationships.

Without guidance about what the Commission considers to potentially be "equivalent", there is an element of subjectivity introduced that could lead similarly situated funds to be reported, or not, differently.

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[50] *Id.* at 9111.

- <u>Counterparty default</u>: Proposed current reporting Item E (counterparty default) would require a large hedge fund adviser to report a margin default by a counterparty. This reporting requirement would be triggered if (i) a counterparty does not meet a call for margin or has failed to make any other payment to the fund, in the time and form contractually required; and (ii) the amount involved is greater than 5% of the most recent NAV of the reporting fund. In the Proposing Release, the Commission provides the following rationale for the 5% trigger:

  > "We believe that 5 percent of the most recent net asset value of the reporting fund is an appropriate threshold in this regard because counterparty defaults of this size could have systemic waterfall effects, triggering forced-selling by the fund and raising potential risks for other hedge funds that may transact with the same counterparty."[51]

  The footnote[52] included in the Proposing Release attached to this quote refers to the FSOC paper[53] from 2016 which, according to the Commission, notes that "large highly interconnected counterparties play a role in whether hedge fund activities have financial stability implications."[54] However, we cannot find this observation in the FSOC paper which only states that "While financial stability risks can be transmitted through direct and indirect exposures of large financial institutions, the risk of direct losses to counterparties is reduced by collateral posted by the hedge funds."[55] Again, we believe the Commission has failed to provide a rationale and, in addition, are referring to a report published in 2016 which we believe is outdated and no longer relevant as evidenced by the industry's strong performance during the COVID-19 crisis.

  With regards to the second prong of Item E as mentioned above, we believe that the counterparty's default should be considered an investment loss rather than a counterparty default. We note that the material trigger introduced under Item B (i.e., loss equal or greater than 20% of the most recent NAV reported on Form PF) is substantially higher than the 5% threshold set under Item E. While we believe none of the events should have a percentage threshold and Item E is best cast as an investment loss and not something separately reportable, if the Commission decides nevertheless to keep the trigger in Item E, we believe the 5% trigger in Item E should not be less than the percentage threshold in Item B (i.e., 20%). In any case, the 5% threshold is set at a disproportionately low percentage and would be triggered relatively easily if a short-lived operational error occurs (which is not entirely uncommon).

- <u>Material change in relationship with prime broker</u>: Item F would require a large hedge fund adviser to report a material change in the relationship between the reporting fund and a prime broker by describing the circumstances relating to the material change, including whether the

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51 *Id.* at 9112.
52 *Id.* at footnote 32.
53 FSOC paper, at pages 15-18.
54 Proposing Release, *supra* note 3, at footnote 32.
55 FSOC paper, at page 18.

change involved (i) material trading limits or investment restrictions on the reporting fund, including requests to reduce positions or unwind positions completely; and (ii) whether the prime brokerage relationship was terminated and by which party. The Proposing Release states that "A prime broker that is no longer willing to provide services to a fund client may be apprehensive of a fund's investment positions or trading practices and may consider the fund to be an unacceptable risk as a counterparty."[56]

We do not entirely understand or see the urgency in requiring large hedge fund advisers to report a material change in its relationship with their prime broker, let alone on a one business day reporting requirement. In the hedge fund industry, starting or terminating a relationship with a prime broker occurs on a frequent basis and is not an indication of potential stress at the fund but, in most instances, is based on business imperatives of either party. Indeed, a number of advisers have reduced or increased their overall prime brokerage business in recent years. The Commission's understanding or concept of material change should be narrowed by defining more circumstances where a report does not need to be filed and providing specific mitigating circumstances that would not require an immediate filing requirement. Moreover, different funds and different prime brokers will all have varying views about what constitutes a material trading limit or investment restriction, making the requirement in Item F subjective and likely to result in inconsistent reporting among reports made by apparently similarly situate large hedge fund advisers.

Reporting should only be required if the reporting fund is in default and cannot meet its obligations towards the prime broker. Item D covers this already, thus Item F does not need to require a duplicate reporting effort. However, if this requirement is kept, it should not be triggered if the termination of the relationship was initiated by the fund due to material breaches of the terms that were agreed between the two parties at the start of their relationship as this is only relevant in the context of investment losses (see the discussion above regarding investment losses).

We also note that "prime broker" is not defined, introducing a level of subjectivity that could lead to different reporting results from similarly situated large hedge fund advisers.

- Changes in unencumbered cash: Under Item G, large hedge fund advisers would be required to file a current report if the value of the fund's unencumbered cash declines by more than 20% of the fund's most recent NAV reported on Form PF over a rolling 10 business day period. We believe that the 20% trigger is inappropriate and will result in false positives and false negatives as discussed above. Moreover, we note that shifts in the amount of unencumbered cash of this magnitude can come from ordinary course deleveraging. The unencumbered cash is there to make closing out of positions possible and to manage the risk of outstanding derivatives positions without causing a liquidity event within the fund. Decreases in unencumbered cash on their own

[56] Proposing Release, *supra* note 3, at 9113.

are not indicative of a potential systemic event and will not be a clear indication of any impending fund failure. Instead, we believe that requiring large hedge fund advisers to notify the Commission when the reporting fund is unable to meet a margin call (as required by Item D) would be a more effective and less burdensome approach.

Finally, we note that the definition of "unencumbered cash" in Form PF is inconsistent with how most hedge fund advisers would calculate unencumbered cash internally. For example, all U.S. Treasuries are considered cash-equivalent under the Form PF rules, even an off-the-run 30-year U.S. Treasury. However, short-dated bills from Japan, UK or Germany are not included as unencumbered cash despite being a critical part of the liquidity pool for many hedge funds. A straightforward rotation from U.S. Dollars to Japanese government bonds would be reportable even though there was no true change to the liquidity position of the fund.

- Operations events: Under Item H, large hedge fund advisers would be required to file a current report with the Commission if the fund or the large hedge fund adviser experiences a "significant disruption or degradation" of the fund's key operations. According to the Proposing Release, "a 'significant disruption or degradation' means a 20 percent disruption or degradation of normal volume or capacity."[57]

  A requirement based on a 20% change of normal volume or capacity presumes that the large hedge fund adviser will need to determine what the "normal volume or capacity" is and will need to have a way to determine this on a daily basis to account for changes that do not lead to a "significant disruption or degradation". The Proposing Release provides no indication about how this base state is to be measured. It instead states, without providing any supportive figures or justification, that the Commission "understands that many large hedge fund advisers have sophisticated back office operations or already engage service providers that would be reasonably able to measure whether an event has impaired their key operation beyond a 20 percent threshold."[58] While this vote of confidence is welcome, it does not address how the Commission means for large hedge fund advisers to make this invariably subjective multi-faceted analysis.

  Because "key operations" means "operations necessary for (i) the investment, trading, valuation, reporting, and risk management of the reporting fund; and (ii) the operation of the reporting fund in accordance with the federal securities laws and regulations [(i.e., governance, compliance, internal audit, internal legal, external legal)]", the "necessary" is incredibly far reaching and will involve the internal functions at the investment adviser and well as the service provision by prime brokers, contracted trading counterparties, executing brokers, custodians, administrators, third party valuation agents, external counsel, compliance consultants, as well as any other types of service providers. The issue is not whether the investment adviser has service level agreements and key performance indicators, which they do. The issue is boiling down all of these continuously moving pieces on a daily basis into a single ***number*** that will allow for the mathematical calculation

57 *Id.* at 9114.
58 *Id.* at 9115.

of a daily percentage change. This will be a very costly exercise on an initial and ongoing basis and the Commission has made no effort to quantify the costs of complying with this requirement beyond the costs of making a single Form PF current report (which does not even contain the filing fee that would attach to such filings).

We strongly object to the underlying assumption and note that disruptions may not always be quantifiable nor are large hedge fund advisers always "reasonably able" to quantify the "volume" or "capacity" of these types of operational activities. The reporting requirement is unclear, open to strong, subjective interpretation by the adviser and lacks any helpful instructions in order for the adviser to understand and determine when it is exactly required to file a notice. For example, if a fund administrator (i.e., service provider) devotes four individuals to the valuation of the reporting fund's assets and one of those individuals goes on holiday, would this then require the adviser to file a notice since this would technically be considered a reportable 25% disruption to the fund's capacity around valuation? If this is what is envisioned, there will be very frequent reports from many large hedge fund advisers.

Even if the adviser would be able to reasonably measure a 20% or higher disruption or degradation, since there are no instructions provided in the Proposing Release, would all qualifying hedge fund advisers follow the same measurement methodology? How should cure periods be addressed in this Item H? In addition, can reporting funds themselves have an "operations event" if they do not have any tangible operations separate from their service providers? If a qualifying operations event occurs at the large hedge fund adviser and impacts the reporting fund, does it not stand to reason that this will then also apply for all the other funds the large hedge fund adviser manages in most cases? These are all questions which the Commission has insufficiently considered but which it should reflect on as the lack of instructions will create confusion and risks advisers falling foul of the reporting requirements while this could be easily avoided.

Moreover, the examples given in the Proposing Release, such as a severe weather event or a cybersecurity event, appear to be adviser-level events as opposed to the other proposed key events which are all fund-level specific. We note that, in particular on the cybersecurity event, the Proposing Release is in direct contrast with other, recent proposals issued by the Commission which require certain advisers to file reports at a later time than the one business day reporting requirement. For example, the proposal on Cybersecurity Risk Management for Investment Advisers, Registered Investment Companies, and Business Development Companies[59] requires registered investment advisers and registered investment companies/business development companies to report significant cybersecurity incidents to the Commission on new Form ADV-C within 48 hours after having a reasonable basis to conclude that a significant cybersecurity incident or a significant fund cybersecurity incident has occurred or is occurring. In addition, in

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[59] SEC, Proposing Release, Cybersecurity Risk management for Investment Advisers, Registered Investment Companies, and Business Development Companies, 87 FR 13524 (Feb. 9, 2022).

another Commission proposal, Cybersecurity Risk Management, Strategy, Governance, and Incident Disclosure,[60] certain advisers are required to disclose information, on amended Form 8-K, about a cybersecurity incident within **four business days** after it has determined that it has experienced a material cybersecurity incident. We question why the Commission is requiring advisers to report cybersecurity incidents on three separate forms (i.e., Form PF, Form ADV-C and Form 8-K), with three separate sets of requirements and with three different reporting deadlines (i.e., one business day, within 48 hours and four business days). We believe, and we expand on this further below, that the Commission should expand the reporting period from one business day to five business days. This would not only apply to Item H but would be applicable for all reporting events under the Proposing Release.

The Proposing Release has again failed to include a rationale for justifying these operations events to be considered systemic risks. It merely states that "We believe that an operations event involving a qualifying hedge fund could have systemic risk implications if the fund is not able to trade as a result of such an event. In addition, notice of operations events from multiple advisers could provide an early indicator of market-wide operations events to both the Commission and FSOC."[61]

Taking into account all of the above, we ask the Commission to delete this requirement entirely. If the Commission instead chooses to retain the reporting event, the Commission should provide a more defined and limited list of operation events to ensure that these are not open to interpretation by the large hedge fund advisers which would otherwise risk them falling foul of this reporting requirement if it has considered a possible operation event but has not deemed it of sufficient importance and relevance to be reported.

If this requirement is retained, the report should not be required within one business day of the adviser's discovery that there appears to be a significant disruption or degradation, especially if the adviser is meant to report a cause. It is often not possible to definitively identify a cause of a disruption or degradation without an investigation. Where one or more other service providers are involved, the investigation may not be capable of being completed in that short a time. As we note above, there is a significant risk that these reports will find their way into the public domain despite the stated confidentially of the filings. Therefore, there is a significant reputational risk for a fund's service providers if the investment adviser identifies one of them as the cause of the significant disruption or degradation in one of these reports without having conducted an investigation to determine the cause. This in turn subjects the reporting investment adviser to litigation risk. All of these indirect costs can be avoided simply by allowing more time and changing "discover an operations event" to "determine that an operations event has occurred and any related cure period has expired".

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[60] SEC, Proposing Release, Cybersecurity, Risk Management, Strategy, Governance, and Incident Disclosure, SEC Rel. No. 33-11038 (Mar. 9, 2022).

[61] Proposing Release, *supra* note 3, at 9115.

Finally, we query what the Commission intends to do if it receives on one of these operations reports on a one business day basis. Will the staff of the Divisions of Examinations or Enforcement be called in? We believe it is not the function of the Commission or its staff to insert itself into the operations or risk management of private fund advisers or the private funds they advise. If the point is simply to provide a roadmap for exams or enforcement, why are reports on the regular Form PF timeframe or a longer than one business day basis not adequate for that purpose?

- Withdrawals and redemptions: Item I would require an adviser to report if it receives cumulative requests for redemption exceeding 50% of the most recent NAV reported on Form PF (after netting against subscriptions and other contributions from investors received and contractually committed). The Proposing Release notes that:

> "[i]n the staff's experience, funds that receive withdrawal requests for half or more of their assets in the period between routine quarterly reports on Form PF may be subject to increased selling and liquidity pressures that could be particularly harmful to investors with potential broader market implications, especially if the fund is invested in more illiquid assets."[62]

As we noted under Item B above and which equally applies here, the Commission does not elaborate on its "staff's experience" nor provides robust data or examples of reporting funds experiencing redemptions exceeding 50% of the fund's most recent NAV reported on Form PF that would justify inclusion of the quantitative threshold. Again, we do not understand how and why the Commission has arrived at this arbitrary threshold. Why has it chosen this particular threshold? Why has it not opted for a higher or lower threshold? The Proposing Release fails to provide a justification.

Regardless, we note that exceeding this threshold may not necessarily reflect potential harm for investors or broader systemic risk. For example, single-investor-funds deploy capital on behalf of a sole (large) institutional investor. A redemption of 50% or higher by such an investor may have been agreed upon by the hedge fund adviser and the investor and would, theoretically, require the former to file a current report with the Commission. However, there is no run risk here and the counterparty contagion risk is no different than it would be if the arrangement was for a separately managed account rather than a vehicle structured as a private fund. For co-mingled qualifying hedge funds, we note that if it the fund is still able to meet redemption payments, this should then not trigger a Commission notification unless a suspension is called.

Rather than requiring large hedge fund advisers to notify the Commission if redemptions exceed 50% of the fund's most recent NAV reported on Form PF, we believe that the Commission should only require a notice filing if the fund is unable to satisfy a redemption request in accordance with the fund's terms or if a suspension is called. As a result, we suggest deleting Item I and retaining Item J which requires a large hedge fund adviser to report if a qualifying fund is unable to satisfy

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[62] *Id*. at 9116.

redemptions or suspends redemptions for more than 5 consecutive business days. The Proposing Release notes that "The 5 consecutive day period is designed to limit reporting of temporary redemption suspensions that we believe have less of an impact on investors or the broader market."[63] We agree with this sensible qualification.

Private equity adviser key events

Our specific concerns with respect to each of the key events for private equity fund advisers are set out below:

- Adviser-led secondary transactions: The Commission proposes to define an adviser-led secondary transaction as any transaction initiated by the private equity adviser or any of its related persons that offers private fund investors the choice to (i) sell all or a portion of their interests in the private fund; or (ii) convert or exchange all or a portion of their interests in the private fund for interests in another vehicle advised by the adviser or any of its related persons.

  The Proposing Release posits that these transactions indicate an inability to sell portfolio companies and could be a leading indicator of a declining market. We note, however, that adviser-led secondary transactions are fairly common, and are used by many established and well-regarded sponsors as a way to provide investors with the option for liquidity while still allowing those investors that wish to do so the opportunity to retain an interest in the underlying investment(s), including well performing assets. Such transactions have also not historically been tied to larger systemic risk. While it is true that conflicts of interest can arise in these types of transactions, conflicts can be mitigated through thoughtful process, disclosure and, where necessary, investor or advisory board consent to the transaction.

  The Commission states that these transactions present conflicts of interests that merit timely reporting and monitoring. However, private equity advisers will only be required to file a notice with the Commission after the transaction has been completed. If this after-the-transaction-reporting-requirement is to determine whether a fairness opinion that has been proposed by the Commission in another pending rule proposal[64] has been issued or that the related conflicts of interest have been appropriately disclosed, we do not understand why disclosing this at a later date, as opposed to the one business day deadline, would not suffice instead. We do not see a compelling reason why this has to be filed within one business day and so we ask that this reporting deadline is extended to five business days.

  Finally, in the Proposing Release, the Commission states that "multiple reports about adviser-led secondary transactions such as a fund reorganization may serve as an early warning to the Commission and FSOC about deteriorating market conditions that may prevent private equity

[63] *Ibid.*
[64] SEC, Proposing Release, Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews, SEC Rel. No. IA-5955 (Feb. 9, 2022), pages 121-132.

managers from utilizing more traditional ways to exit their portfolio companies and realize gain."[65] We note that this observation fundamentally mischaracterises these transactions as they are not indicative of market stress but are accretive and demonstrate the strong and desired growth of the private equity industry. We refer the Commission to a report published by Jefferies in July 2021 which observed that, in 2020, GP-led secondary transaction volumes rose to $35 billion from $26 billion in 2019.[66] For 2021, however, the estimated transaction volume rose to $68 billion.[67] These adviser-led transactions are not a result of increasing market stress but can be attributed to the growth of private equity funds which, we believe, is a reflection of the growing secondary transaction market which the Commission and FSOC should view as a positive development as limited partners are able to access these to fulfil their liquidity needs.

- <u>General partner or limited partner clawback</u>: Here the Commission requires private equity advisers to file a current report if there is a (i) general partner clawback; or (ii) limited partner clawback in excess of an aggregate amount equal to 10% of the fund's aggregate capital commitments.

  We note that these types of clawbacks are most likely to occur later in the life of a fund as long-term assets are realised and performance payments are made or where the realisations from later realised investments have not been sufficient to meet the private equity fund costs, all of which we stress are common in the industry. Furthermore, it is not clear that the 10% threshold applies to the general partner clawback as the threshold appears to only apply to a limited partner clawback. If it does apply to general partner clawbacks, why is the Commission of the opinion that 10% of limited partner commitments is the right threshold? If it does not apply to general partner clawbacks, this would mean that no threshold applies and that any general partner clawback, regardless of the amount or percentage, would be reportable under the Proposing Release, which will increase the potential reporting frequency, decrease the potential usefulness of the reports and increase the costs for advisers dealing with enquiries about these reports from the Commission staff and investors.

  We note that clawbacks also occur at closed-end private equity funds so we do not understand why these clawbacks would possibly be considered as indicative of a potential financial stability concern. The Proposing Release states: "We believe requiring the proposed minimum threshold is appropriate because we believe a clawback of this magnitude would be associated with an event that could have a significant negative impact on a fund's investors and, if a pattern emerges among multiple private equity advisers, could indicate financial stability concerns."[68] Closed-end funds are by nature not subject to run risk and performance compensation clawbacks do not seem to have a counterparty contagion risk either. It is therefore difficult to see where there would a financial stability concern. If the clawback is because of the individual investments, many of which

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65 Proposing Release, *supra* note 3, at 9132.

66 Jefferies, Global Secondary Market Review (Jul. 2021).

67 *See*, Pitchbook, Continuation funds drive GP-led secondaries wave (Feb. 1, 2022).

68 Proposing Release, *supra* note 3, at 9118.

are limited to specific private equity managers due to the bespoke nature of the transactions, then why does the Commission believe that there could ever be a relevant "pattern" among multiple private equity advisers?

Finally, we note that private equity funds, through their advisers, provide limited partners with information on the status of their investments and distributions in a fund on a frequent, quarterly basis and so we believe that the proposed reporting requirement is obsolete. These frequent updates would then inform them if a private equity fund is eligible to receive carried interest or if a clawback is required. Considering the illiquid nature of private equity assets - and the fact that their value cannot be as accurately defined as a public security – but also taking into account the manner as to how a private equity fund calculates carried interest and clawback, this may result in "false positives" for the Commission in one quarter, with the fund in clawback one quarter but not in the next quarter.

- Removal of a general partner, termination of the investment period or termination of a fund: Item D of Section 6 would require private equity advisers to file a current report if investors have (i) removed the private equity adviser or an affiliate as the general partner or similar control person of the relevant fund, (ii) elected to terminate the relevant fund's investment period or (iii) elected to terminate the relevant fund. The Commission does not explain why a report within one business day is necessary nor does the Commission provide any guidance about situations that should not cause a reporting requirement to limit false positive reports. Investor protection is a weak justification for this reporting requirement as the trigger is premised on investors taking action.

6. If the Commission adopts the key events as proposed, the one business day reporting period should be expanded to five business days

We strongly believe that the proposed one business day reporting requirement is too short and will increase administrative burdens and costs to an extent that is not proportionate to the perceived benefit. We are deeply concerned with the profound impact the proposed reporting requirements will have on advisers in scope of the new requirements, coupled with the other Rules that have been proposed by the Commission. The proposed one business day reporting requirement is arbitrary and is an insufficient period of time for advisers to assess and monitor the gravity and impact of the occurrence of certain key events which may, in practice, not always be reflective of a crisis but rather an isolated event not indicative of a wider systemic (market) crisis. Our members are of the opinion that the one-day reporting deadline may result in compliance pitfalls more than it provides a reasonable method to inform the Commission and its staff of important events. Moreover, we question whether the Commission has adequate staffing and resources to parse through and react to the likely greater than estimated number of Form PF current reports.

The reporting requirements focus on market-influenced changes in a fund's portfolio and balance sheet, such as significant losses and fluctuations in margin requirements, which may be more obvious signs of systemic risk. However, such triggers can occur concurrent with market volatility that can be

sudden. Undertaking to identify, quantify and report such occurrences in a single business day, for funds operating across multiple jurisdictions, will be burdensome for advisers to both implement and monitor. We note that, for non-U.S. advisers, the one-day reporting obligation will be especially burdensome as they will effectively have same-day reporting obligations.

The Proposing Release also suggests that current reports may be subject to a requirement to update, in contrast to current rules for Form PF, which advisers are only required to update on a quarterly basis, and Form ADV, which is only updated other than annually for a limited specified set of material changes. While the Commission has assumed such current reports would be rare, and therefore updates to such reports even more rare, for advisers with those events compiling and monitoring for necessary updates can pose a significant administrative burden. Furthermore, this real-time monitoring and reporting requirement is a significant departure from similar reporting regimes, such as: (i) the four business day reporting period for Form 8-K; (ii) the "prompt" reporting of arguably more significant changes relating to an adviser and its funds for certain amendments to Form ADV, which is generally interpreted to mean within 30 days; and (iii) Form CRS, which advisers and broker-dealers must amend within 30 days whenever any information becomes materially inaccurate.

We note that advisers seeking to comply with the proposed requirement would need to invest a significant amount in automated reporting as the reporting events and the material triggers and thresholds behind them are not currently monitored under any existing regulatory reporting regime or for internal risk management purposes. Moreover, the amendments would create significant stress on the compliance departments of many advisers. The one business day deadline would be among the shortest, if not the shortest, deadline for any 'reactive' Commission reports that are required after the occurrence of an event that may be beyond a filer's knowledge or control. It will not be practicable in many organisations, particularly large and mid-sized companies that operate across many time zones, to collect, assemble and file this information within that deadline. By contrast, even beneficial ownership reporting under the Securities Exchange Act of 1934, as amended, which is significantly less onerous than the proposed Form PF amendments, provides a longer reporting period.

Advisers will not only be required to set up a system for monitoring significant events and the associated filing fees, but in addition will have to allocate internal and external resources to each, individual current report, such as (internal) compliance employees, senior management, and internal and external counsel. With limited time to submit a report after the occurrence of a triggering event, compliance with the reporting requirement may strain resources that could be used to address a triggering event at critical times for a fund. We have provided our views on the omission of a cost and reporting burden impact assessment above which does not provide a transparent and well-considered analysis of the Proposal's effects on individual advisers' business operations.

Moreover, we note several practical issues that would arise with the one business day reporting requirement which we believe the Commission has not considered. For example, has the Commission considered the differences in time zones within and outside the U.S. which may result in an adviser

falling foul of the reporting requirement? Has the Commission considered foreign holidays which would prevent an adviser from filing their current report within one business day? What if the event occurred but the adviser was not aware until later? The Proposing Release does not answer any of these questions and the practical issues that would arise if the amendments were adopted as proposed.

We also believe that the compliance and operational costs associated with these proposed requirements would significantly increase the barriers to entry for new advisers.

Considering all of the above, if the Commission adopts the proposed reporting requirements, we respectfully ask that the reporting period be expanded from one business day to five business days. As outlined below, the cost/benefit analysis has not fully considered the resource and cost burden the reporting requirements would introduce on advisers. We believe that, if the Commission adopts the key events as proposed, five business days is a reasonable and proportionate period of time to allow advisers to assess and mitigate the occurrence of key events while also notifying the Commission of such an event. We do not see the added benefit or absolute necessity of a one business day reporting deadline, nor has the Commission provided a satisfying explanation as to why a one business day would be necessary to achieve its goals to "enhance FSOC's monitoring and assessment of systemic risk and to provide additional information for FSOC's use in determining whether and how to deploy its regulatory tools" and "to collect additional data for the Commission's use in its regulatory programs, including examinations, investigations and investor protection efforts relating to private fund advisers."[69] If the Commission decides to adopt the proposed amendments for Form PF, a five business day reporting period would be wholly sufficient to achieve these goals.

7. Conclusion

Our members' widely shared concern is that the proposed amendments, which the Commission argues will improve its understanding of the private fund industry and the potential systemic risk within it, will create more uncertainties, generate more operational costs to apply the changes and ultimately reduce bandwidth to focus on what our members do best: provide liquidity on capital markets, contribute to a diverse, vibrant, open and ultimately trustworthy economic environment and/or directly finance corporates, from large blue-chip companies to local SMEs. Our overall view of the Proposing Release is that the Commission is seeking to resolve a problem where there is none and has not provided a balanced and elaborate overview of the costs involved and the impact it introduces on the industry.

Without providing a comprehensive overview of the exact benefits and costs of the proposed amendments, as well as the exact purposes the data would serve, we respectfully ask the Commission to reconsider the Proposing Release and to engage with industry stakeholders on how Form PF should be updated in order to improve the Commission's and FSOC's objective to monitor and mitigate a potential build-up of systemic risk. The Commission should not proceed, or at the very least, pause

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[69] Proposing Release, *supra* note 3, at 9107.

this rulemaking and instead conduct a comprehensive exercise which would provide the necessary information and policy justification for these amendments to be adopted.