February 8, 2022

SEC Proposal for Amendments to Form PF[1]

The U.S. Securities and Exchange Commission (SEC) has proposed amendments to enhance private fund reporting on Form PF. The adopting release explains that, in light of the growth of the private fund industry since Form PF's inception in 2011, "information gaps and situations where more granular and timely information would improve [their] understanding of the private fund industry and the potential systemic risk relating to its activities, and improve regulators' ability to protect investors."

While the proposal introduces three major changes to Form PF, the changes relating to large hedge fund advisers and (large) private equity advisers will likely be of most relevance and interest to AIMA/ACC members. This summary covers all three changes but details the proposed changes that are applicable to large hedge fund advisers and (large) private equity advisers.[2]

AIMA, together with MFA, have previously provided comments and suggested amendments to Form PF to improve the accuracy and relevance of the information it seeks from private funds.

Large hedge fund advisers

Under the proposal, large hedge fund advisers (i.e., those with at least $1.5 billion of regulatory assets under management ('RAUM') attributable to hedge funds it advises) would be required to file reports within **one** business day of the occurrence of one or more major reporting events affecting a qualifying hedge fund it advises. The proposal refers to the March 2020 market turmoil and the January 2021 stock volatility events which "highlighted the importance of receiving current information from market participants during fast moving market events." The Commission, and the Financial Stability Oversight Council (FSOC), would use the data to assess the impact on investors and the financial system, and any potential regulatory responses.

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1 "Amendments to Form PF to Require Current Reporting and Amend Reporting Requirements for Large Private Equity Advisers and Large Liquidity Fund Advisers", SEC Rel. Nos. IA-5950 (Jan. 26, 2022) (the 'proposal').

2 A "hedge fund", as defined under Form PF, is "[a]"ny private fund (other than a securitized asset fund):

> (a) with respect to which one or more investment advisers (or related persons of investment advisers) may be paid a performance fee or allocation calculated by taking into account unrealized gains (other than a fee or allocation the calculation of which may take into account unrealized gains solely for the purpose of reducing such fee or allocation to reflect net unrealized losses);
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> (b) that may borrow an amount in excess of one-half of its net asset value (including any committed capital) or may have gross notional exposure in excess of twice its net asset value (including any committed capital); or
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> (c) that may sell securities or other assets short or enter into similar transactions (other than for the purpose of hedging currency exposure or managing duration)."

Form PF defines a "private equity fund" as "[a]ny private fund that is not a hedge fund, liquidity fund, real estate fund, securitized asset fund or venture capital fund and does not provide investors with redemption rights in the ordinary course".

On these definitions, some private credit funds may be considered hedge funds, but others will be considered private equity funds despite not investing in equity at all. The proposal seeks to gather more information about private credit funds that are treated as private equity funds for purposes of reporting on Form PF.

A new section 5 to Form PF has been proposed which covers a range of events and also incorporates objective tests to allow advisers to determine whether a report must be filed with respect to a qualifying hedge fund it advises. The key events that would trigger a requirement to report are:

1. Extraordinary investment losses: A large hedge fund adviser would be required to file a Form PF current report within one business day after the reporting fund experiences a loss equal to or greater than 20% of a fund's "most recent net asset value"[3] over a rolling 10 business day period. The adviser must file information on (i) the dates of the 10 business day period over which the loss occurred, and (ii) the dollar amount of the loss.

2. Significant margin and default events: According to the Commission, significant increases in margin, inability to meet a margin call, margin default, and default of a counterparty are strong indicators of fund and potential market stress.

   Items C-E on Section 5 would require current reporting of significant margin and default events that occur at reporting funds or at their counterparties. Item C would require the adviser to report (i) the dates of the 10 business day period over which the increase occurred; (ii) the cumulative dollar amount of the increase; and (iii) the identity of the counterparty or counterparties requiring the increase(s). Item D would require advisers to report a fund's margin default or inability to meet a call for margin, collateral, or an equivalent (taking into account any contractually agreed cure period). The adviser would report for each separate counterparty for which this occurred: (i) the date the adviser determines or is notified that a reporting fund is in margin default or will be unable to meet a margin call with respect to a counterparty; (ii) the dollar amount of the margin, collateral or equivalent involved; and (iii) the legal name and LEI (if any) of the counterparty.

   Item E requires an adviser to report a margin default by a counterparty. A report would be triggered if a counterparty to the reporting fund (i) does not meet a call for margin or has failed to make any other payment, in the time and form contractually required (taking into account any contractually agreed cure period); and (ii) the amount involved is greater than 5 percent of the most recent net asset value ('NAV') of the reporting fund. Under Item E, the adviser must report: (i) the date of the default; (ii) the dollar amount of the default; and (iii) the legal name and LEI (if any) of the counterparty.

3. Material change in relationship with prime broker: Item F would require the adviser to report a material change in the relationship between the reporting fund and a prime broker. Material changes in a reporting fund's prime brokerage relationships may signal that the fund or the brokers with whom the fund transacts are experiencing stress and may be subject to an increased risk of default, or in the case of the reporting fund, potential liquidation. Item F would require the adviser to provide the date of the material change and the legal name and LEI (if any) of the prime broker involved. An adviser also would check any applicable boxes that describe the circumstances relating to the material change, including whether the change involved (i) material trading limits or investment restrictions on the reporting fund, including requests to reduce

[3] A fund's "most recent net asset value" for purposes of these requirements is its net asset value (i.e., the gross assets reported in response to Question 8 of Form PF minus any outstanding indebtedness or other accrued but unpaid liabilities) as of the data reporting date at the end of the fund's most recent Form PF reporting period, not the fund's daily NAV or even its NAV as of its most recent dealing day.

positions, or unwind positions completely; and (ii) whether the prime brokerage relationship was terminated and by which party.

4. <u>Changes in unencumbered cash</u>: Item G requires the adviser to report a significant decline in holdings of unencumbered cash. A report for changes in unencumbered cash would be triggered if the value of the reporting fund's unencumbered cash declines by more than 20% of the reporting fund's most recent net asset value over a rolling 10 business day period. To report significant changes, advisers would need to calculate a daily unencumbered cash figure using the same methodology they use to calculate question 33 on the current form ('*Value* of *reporting fund's unencumbered cash').* If this trigger is met, the adviser would report the last day of the rolling 10 business day period during which the unencumbered cash declined and the dollar amount of the unencumbered cash on the last day of the period. Item G would also include explanatory checkboxes for the adviser to provide additional information concerning its current understanding of the facts and circumstances around the change in unencumbered cash.

5. <u>Operation events</u> Item H would require the adviser to report when the adviser or reporting fund experiences a "significant disruption or degradation" of the reporting fund's "key operations," whether as a result of an event at the reporting fund, the adviser or other service provider to the reporting fund. Key operations for this purpose 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." Examples of these "significant disruption or degradation" events include severe weather events causing wide-spread power outages, a cybersecurity event that disrupted the trading volume of a reporting fund by 20% of its normal capacity, or if an adviser's ability to value the fund's assets is significantly disrupted or degraded, for example, in connection with operational issues at a service provider.

6. <u>Withdrawals and redemptions</u>: Item I would require an adviser to report if it receives cumulative requests for redemption exceeding 50% of the most recent net asset value (after netting against subscriptions and other contributions from investors received and contractually committed). An adviser would report: (i) the date on which the net redemption requests exceeded 50% of the most recent net asset value; (ii) the net value of redemptions paid from the reporting fund between the last data reporting date (the end of the most recently reported fiscal quarter on Form PF) and the date of the current report; (iii) the percentage of the fund's most recent net asset value for which redemptions have been requested; and (iv) whether the adviser has notified the investors that the reporting fund will liquidate.

7. <u>Unable to satisfy redemptions or suspension of redemptions</u>: Item J would require an adviser to report if a fund is unable to satisfy redemptions or suspends redemptions for more than 5 consecutive business days. The adviser would report: (i) the date the reporting fund was unable to pay redemption requests or suspended redemptions; (ii) the percentage of redemptions requested and not yet paid; and (iii) whether the adviser has notified the investors that the reporting fund will liquidate.

Large private equity advisers

The proposal notes that "given the increased demand for exposure to private equity among institutional investors, private equity advisers have expanded the breadth of their investment strategies and the types of offerings, including a significant increase in **private credit strategies**, which raises questions regarding lending practices that could raise systemic risk concerns" (emphasis added).

In this regard, the Commission is proposing to add Question 68 to Section 4 to collect information about private equity fund investment strategies, including private credit (and associated sub-strategies such as distressed debt, senior debt, special situations, etc.). Advisers will need to indicate the strategy that best describes the reporting fund's investment strategy by percent of deployed capital. Large private equity fund advisers would be required to disclose more information regarding fund strategies, use of leverage and portfolio company financings, controlled portfolio companies (CPC) and CPC borrowings, fund investments in different levels of a single portfolio company's capital structure, and portfolio company restructurings or recapitalisations.

Furthermore, the proposal would lower the threshold for which advisers of private equity funds have to file Section 4 of Form PF from at least $2 billion of private equity fund assets under management to at least $1.5 billion.

All advisers of private equity funds

Private equity advisers, similar to large hedge fund advisers, will also need to file reports within one business day upon the occurrence of certain reporting events. Note that, unlike with respect to the current reporting requirements for "large hedge fund advisers" as outlined above, the reporting is not limited to "large private equity fund advisers" and there is no threshold related to the size of the funds, so a "reporting event" occurring at any "private equity fund" (regardless of size) would trigger the current reporting requirement.

New Section 6 will require private equity fund advisers to report the following reporting events:

1. <u>Adviser-led secondary transactions</u>: Section 6, Item B would require reporting upon the completion of an adviser-led secondary transaction. The execution of an adviser-led secondary transaction will trigger a requirement to report within one business day of the completion of the transaction on (i) the transaction completion date; and (ii) a brief description of the transaction. For this purpose, an "adviser -led secondary transaction" includes "[a]ny transaction initiated by the adviser or any of its related persons that offers the investors the choice to: (1) sell all or a portion of their interests in the private fund; or (2) 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").

2. <u>General partner or limited partner clawback</u>: Item C would require reporting upon the implementation of a general partner clawback or a limited partner clawback (or clawbacks) in excess of an aggregate amount equal to 10 percent of a fund's aggregate capital commitments. For this purpose, a general partner clawback is "any obligation of the general partner, its related persons, or their respective owners or interest holders to restore or otherwise return performance-based compensation to the fund pursuant to the fund's governing agreements". A limited partner clawback or "giveback" is "an obligation of a fund's investors to return all or any portion of a distribution made by the fund to satisfy a liability, obligation, or expense of the fund

pursuant to the fund's governing agreements". A general and limited partner clawback will trigger a requirement to report (i) the effective date of the clawback and (ii) the reason for the clawback.

3. **Removal of a general partner, termination of the investment period or termination of a fund**: Item D would require an adviser to report when a fund receives notification that fund investors have: (i) removed the adviser or an affiliate as the general partner or similar control person of a fund; (ii) elected to terminate the fund's investment period; or (iii) elected to terminate the fund, in each case as contemplated by the fund documents. The Commission argues that any of these events could provide an indication of market deterioration and raise investor protection issues. If these events occur, the adviser must report (i) the effective date of the event and (ii) a description of such event.

Large liquidity fund advisers

The proposal would require large liquidity fund advisers – those with at least $1 billion in combined AUM attributable to liquidity funds and registered money market funds (MMFs) – to report substantially the same information that MMFs would report on Form N-MFP, which the Commission also proposes amending. Together, Form N-MFP and Form PF are designed to provide a complete picture of the short-term financing markets in which MMFs and liquidity funds both invest. The Commission notes that the amendments are designed to enhance their and FSOC's ability to assess short-term financing markets and to facilitate their oversight of those markets and their participants.

Next steps

There will be a 30-day comment period following publication in the Federal Register. AIMA will seek input from members and intends to provide formal comments to the Commission during that period. Please let Remmert Keijzer know if you would like to be involved in this effort.

Chair Gensler signalled, as part of his remarks at the open meeting where the Commission agreed to propose these amendments, that the Commission intends to coordinate with the CFTC about further amendments to Form PF in the sections that constitute joint requirements of the SEC and CFTC. As a result, a further set of proposed amendments to the rest of the form may be forthcoming later this year. We will let members know if we hear anything further in this regard.