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Proposed Private Fund Disclosure Form

Background. The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), which was signed into law on July 21, 2010, was designed in part "to promote the financial stability of the United States by, among other measures, establishing better monitoring of systemic risks to the nation's financial system." The Dodd-Frank Act created the Financial Stability Oversight Council ("FSOC") to monitor systemic risks to financial stability. Title IV of the Dodd-Frank Act amended the Investment Advisers Act of 1940, as amended to require that most advisers of hedge funds and other private investment funds register with the Securities and Exchange Commission ("SEC") as investment advisers and Section 404 of the Dodd-Frank Act requires that such registered private fund advisers maintain such records and file such reports as the SEC, by rule, deems necessary for the assessment of systemic risk by the FSOC.

Consequently, the SEC, together with the Commodity Futures Trading Commission ("CFTC"), jointly issued proposed Rule 204(b)-1 (the "Rule") which requires private fund advisers to file Form PF with the SEC. The Rule would also apply to private fund advisers who are also registered with the CFTC as CPO's (commodity pool operators) or CTA's (commodity trading advisers).

Who Must File. Any private fund adviser which is required to register as an adviser with the SEC is required to file a Form PF. Generally, under Title IV of the Dodd-Frank Act, private fund advisers with more than \$150 million in assets under management are so required.

The amount and type of information which a private fund adviser is required to report varies with both the size of the funds which the adviser manages and the type of funds it advises.

The Rule governs three types of funds – hedge funds, liquidity funds and private equity funds. The Rule also differentiates between private fund advisers on the basis of the amount of assets under management – small private fund advisers which have less than \$1 billion in assets under management and large private fund advisers which have more than \$1 billion under management. Whether this threshold has been exceeded is determined on a daily basis for hedge funds and liquidity funds, described below, and on a quarterly basis for private equity funds, also described below.

The Rule defines a hedge fund as a private fund that (a) has a performance fee or allocation calculated by taking into account unrealized gain, (b) may borrow an amount in excess of one-half of its net asset value (including committed capital) or may have gross notional exposure in excess of twice its net asset value (including committed capital) or (c) may sell securities or other assets short. A liquidity fund is a private fund which seeks to generate income by investing in a portfolio of short term obligations in order to maintain a stable net asset value per unit or minimize principal volatility. A private equity fund is one which 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.

What Must Be Reported. All private fund advisers, regardless of the type of fund or size, must provide the information called for in Section 1 of Form PF. Section 1(a) of Form PF

requires reporting of:

- Name of the adviser;
- Name of related persons whose information is also reported in the adviser's Form PF; and
- Basic aggregate information about the funds managed by the adviser such as total and net assets under management, and the amount of such assets attributable to certain types of private funds.

Section 1(b) requires reporting as to each private fund advised by the reporting adviser (excluding feeder funds which are part of a master-feeder structure), including:

- Each fund's gross and net assets and aggregate notional value of its derivative positions;
- Information concerning each fund's borrowings, based on whether the fund's creditors are US or foreign institutions or non-financial institutions, the identity of such creditors, the amount owed in excess of 5 percent of such fund's net market value;
- Concentration of the fund's investor base; and
- Monthly and quarterly performance information.

Section 1 (c) requires, for hedge fund advisers only, disclosures of:

- Investment strategies;
- Percentage of the fund's assets managed using computer-driven algorithms;
- Significant trading counterparty exposures; and
- Trading and clearing practices.

Section 2 of Form PF must be completed by large hedge fund advisers, i.e. those with \$1 billion under management. Section 2(a) requires aggregate information as to all hedge funds managed by the adviser including:

- Market value of assets invested (on a short and long basis) in different types of securities and commodities;
- Duration of fixed income portfolio holdings;
- Interest rate sensitivity of assets;
- Turnover rate during the reporting period; and
- Geographic breakdown of investments.

Section 2 (b) of Form PF would require large hedge fund advisers to report additional information concerning any hedge fund they advise having a net asset value in excess of \$500 million as of the close of business on any day during the reporting period. In addition to requiring the information required in Section 2(a) for each hedge fund, Section 2(b) would also require disclosure of:

- Each hedge fund's liquidity;
- Concentration of positions;
- Collateral practices with significant counterparties;
- The three central clearing counterparties with which the fund has the greatest net counterparty credit exposure;
- Hedge fund risk metrics;
- Certain financing information, including a monthly breakdown of the fund's secured and unsecured borrowings, derivative exposure, collateral values, letters of credit, term of the fund's committed financing, and types of creditors; and
- Each fund's investor composition and liquidity.

Private fund advisers managing a liquidity fund with \$1 billion in assets (including any registered money market funds managed by the adviser) must complete Section 3 of Form PF which requires disclosure of, with respect to each liquidity fund managed, the following:

- The method of valuation utilized by the fund – the amortized cost method and/or the penny rounding method;
- Whether the fund is managed in compliance with certain provisions of Rule 2a-7 under the Investment Company Act of 1940;
- Monthly net asset value, net asset value per share, market-based net asset value, weighted average maturity, weighted average life, 7-day gross yield, amount of daily and weekly liquid assets and amount of assets with greater than 397 days maturity;
- Amount of assets invested in different types of instruments, broken down by maturity;
- Information for each open position representing more than 5 percent of the fund's net asset value;
- Information relative to secured and unsecured borrowing, broken down by creditor type, and the maturity profile of the borrowing and whether the fund has a liquidity facility;
- Information concerning concentration of the fund's investor base and the fund's gating and redemption policies and investor liquidity; and
- Estimate of the percentage of the fund assets purchased using securities lending collateral.

Advisers managing private equity funds with assets of at least \$1 billion would be required to complete Section 4 of Form PF which requires the following information:

- Outstanding balance of the fund's borrowings and guaranties;
- Weighted average debt-to-equity ratio of portfolio companies and the range of debt-to-equity among such portfolio companies;
- Maturity profile of each portfolio company's debt, the portion of such debt that is zero coupon or payment-in-kind, any defaults with respect to any portfolio company's debt;
- Identity of bridge lenders to the portfolio companies and the amount of such loans
- Financial industry investments, including the name of the portfolio company, debt-to-equity ratio and percentage of such portfolio company owned by the fund;
- Co-investments by the fund's related persons in any portfolio company; and
- Geographic and industry breakdown relative to the fund's portfolio companies.

Confidentiality. As noted above, Form PF will elicit significant non-public information about private funds. However, the Dodd-Frank Act specifies that such information derived from Form PF and provided to the FSOC by the SEC will be subject to the confidentiality provisions of Section 404 of the Dodd-Frank Act.

When Form PF Must Be Filed. For small private fund advisers required only to complete and file Section 1 of Form PF, the filing is due annually, no later than the date on which the adviser must file its annual updating amendment to its Form ADV (currently 90 days after the end of the adviser's fiscal year). Large private fund advisers which are required to complete and file Sections 2, 3 or 4 of Form PF, in addition to Section 1, must file quarterly, no later than 15 days following the end of each calendar quarter.

The proposed compliance date for the Form PF filings is December 15, 2011, with large private fund advisers being required to file their first quarterly report by January 15, 2012. Small private fund advisers would be required to file their first Form PF 90 days after the end of their first fiscal year ending on or after December 15, 2011.

Miller & Martin PLLC will monitor the Rule and Form PF as they go through the SEC's comment period of sixty days and will further advise clients with respect to the final rule and form. If you have any questions, please feel free to contact [Scott McGinness](#) or [Clint Cromwell](#).

The opinions expressed in this bulletin are intended for general guidance only. They are not intended as recommendations for specific situations. As always, readers should consult a qualified attorney for specific legal guidance. Should you need assistance from a Miller & Martin attorney, please call 1-800-275-7303.

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