



Investment Management Update

November 2011

SEC Approves Form PF

On October 26, 2011, the Securities and Exchange Commission (SEC) adopted Rule 204b-1 under the Investment Advisers Act of 1940 ("Advisers Act"). The rule requires investment advisers registered with the SEC that advise one or more private funds and have at least \$150 million in private fund assets under management to file Form PF with the SEC.¹ The new rule implements provisions of Title IV of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") that require the SEC to establish reporting and recordkeeping requirements for advisers to private funds. The information collected on Form PF will be provided to the Financial Stability Oversight Council (FSOC), which will use the information to monitor and assess the systemic risk to the U.S. financial system posed by private funds. The information reported on Form PF is intended to complement information the SEC collects on Form ADV.

The staffs of the SEC and the CFTC consulted the United Kingdom's Financial Services Authority (FSA), the European Securities and Markets Authority (ESMA), the International Organization of Securities Commissioners and Hong Kong's Securities and Futures Commission in developing the new rule and Form PF. The Release states that Form PF collects many of the types of information collected by the FSA and proposed to be collected by the ESMA, thus aligning Form PF with international approaches to private fund reporting.

Who Must File

Only an investment adviser registered or required to be registered with the SEC (including any investment adviser that also is registered or required to register with the CFTC

as a CPO or a CTA) that advises one or more private funds and that had at least \$150 million in regulatory assets under management attributable to private funds at the end of its most recently completed fiscal year is required to file Form PF.² Advisers solely to venture capital funds or advisers solely to private funds that in the aggregate have less than \$150 million in assets under management in the United States that rely on the exemptions from registration under Sections 203(l) or 203(m), respectively, of the Advisers Act (collectively, "exempt reporting advisers") are not required to file Form PF. Form PF will be filed electronically on the Investment Adviser Registration Depository (IARD).

Categories of Advisers

Form PF divides advisers into two categories: small private fund advisers and large private fund advisers ("Large Private Fund Advisers"). Large Private Fund Advisers include any adviser having at least \$1.5 billion in regulatory assets under management attributable to hedge funds as of the end of any month in the prior fiscal quarter ("Large Hedge Fund Advisers"), any adviser managing a liquidity fund and having at least \$1 billion in regulatory assets under management attributable to liquidity funds and registered money market funds as of the end of any month in the prior fiscal quarter ("Large Liquidity Fund Advisers") and any adviser having at least \$2 billion in regulatory assets under management attributable to private equity funds as of the end of the adviser's most recently completed fiscal year ("Large Private Equity Advisers").³ Each type of private fund adviser is required to complete different sections of Form PF.

Aggregation of Assets Under Management

In determining whether a private fund adviser meets the \$150 million threshold or is a Large Private Fund Adviser, the adviser must aggregate assets of parallel managed accounts, private funds that are part of the same master-feeder structure, private funds that are part of the same parallel fund structure⁴ and private funds advised by any of the adviser's related persons other than related persons that are separately operated.⁵

The Release defines "parallel managed accounts" as accounts advised by the adviser that pursue substantially the same investment objective and strategy and that invest in substantially the same positions as private funds advised by the adviser. "Related persons" for purposes of Form PF are defined as all the adviser's officers, partners or directors (or persons performing similar functions); all persons controlling, controlled by or under common control with the adviser; and all the adviser's employees (other than those performing administrative or clerical functions).

The aggregation requirements are designed to preclude advisers from structuring (or restructuring) private funds in ways that circumvent the Form PF reporting requirements.

Excluded Assets

In determining the reporting thresholds and in completing Form PF, advisers may exclude any assets invested in other private funds. If an adviser's principal office and place of business is outside the United States, the adviser also may exclude any private fund that, during the adviser's last fiscal year, was not a United States person, was not offered in the United States and was not beneficially owned by any United States person.

Affiliated and Sub-Advised Funds

An adviser is permitted to report on one Form PF both the private fund assets that it manages and the private fund assets that its related persons manage. However, it is not required to file a single report for both advisers.

To prevent duplicative reporting, only one adviser should report information with respect to a sub-advised fund. Only the adviser that completes Schedule D to Form ADV with respect to the private fund and that also is required

to file Form PF should report on Form PF for the sub-advised fund. However, if that adviser is not required to file Form PF (e.g., it is an exempt reporting adviser), then another adviser required to file Form PF must report the sub-advised on its Form PF. If none of the advisers to a sub-advised fund are required to file Form PF, then the form is not required to be filed.

Frequency of Reporting

Small private fund advisers and Large Private Equity Advisers are required to file Form PF annually. The form must be filed within 120 calendar days of the end of the fiscal year. Large Hedge Fund Advisers and Large Liquidity Fund Advisers must file Form PF quarterly. The form must be filed by Large Hedge Fund Advisers within 60 calendar days of the end of the fiscal quarter and by Large Liquidity Fund Advisers within 15 calendar days of the end of the fiscal quarter.

A newly registered adviser is not required to file Form PF with respect to any period that ended prior to the effective date of its registration. For example, a Large Hedge Fund Adviser that registers during the third quarter of 2012 would need to file its initial report within 60 days of the end of that quarter, but would not need to file for the preceding fiscal quarter.

If an adviser transitions from filing quarterly to filing annual reports or is no longer required to file Form PF, it must file a Form PF to report this change no later than the last day on which its next Form PF update would be timely filed.

Confidentiality of Form PF Data

Form PF is filed with the SEC pursuant to Section 204(b) of the Advisers Act, making the contents of the report subject to the confidentiality protections applicable to data required to be filed under that section. Under Section 204(b), which was added by the Dodd-Frank Act, the SEC cannot be compelled to disclose any report or information in any report required to be filed with it, except to Congress or to comply with a court order or a request of any other federal department or agency or self-regulatory organization acting within the scope of its jurisdiction. The Release states that each federal department or agency or self-regulatory organization with whom the SEC shares

information also will be exempt from being compelled to disclose the information and must maintain the confidentiality of the information consistent with the level of confidentiality established for the SEC in Section 204(b) of the Advisers Act. The SEC states that prior to sharing any Form PF data, it intends to require that any department or agency or self-regulatory organization represent that it has in place controls designed to ensure the use and handling of Form PF data in a manner consistent with the protections established in the Dodd-Frank Act.

Congress is not subject to the confidentiality requirements in Section 204(b).

The SEC has stressed the importance of international regulatory coordination in collecting comparable information regarding private funds that will aid the SEC, the FSA and other regulators in assessing systemic risk on a global basis. To the extent that the SEC may share information collected on Form PF with international regulators, there can be no assurance that those regulators will be subject to confidentiality requirements comparable to those in Section 204(b) of the Advisers Act.

Information Reported on Form PF

Form PF consists of four parts. Most private fund advisers will complete only Section 1. However, Large Hedge Fund Advisers are required to complete Section 2, while Large Liquidity Fund Advisers and Large Private Equity Advisers are required to complete Sections 3 and 4, respectively. Each section focuses on areas of financial activity specific to the type of private fund required to complete the section that have the potential to raise systemic concerns.

Section 1 – All Form PF Filers

Each private fund adviser is required to complete Section 1, which is divided into three parts. Section 1a seeks identifying information about the adviser and aggregate information about the private funds managed by the adviser, including whether the assets are managed rather than owned. This type of information will be considered by the FSOC in making a determination to designate a nonbank financial company for Federal Reserve Board (FRB) supervision under Dodd-Frank.

Section 1b solicits certain information about each private fund an adviser manages, including gross and net assets, notional value of derivatives, borrowings, performance and a breakdown of each private fund's assets and liabilities. This section also requires disclosure of the approximate percentages of each private fund beneficially owned by certain types of investors and the percentage of the fund's equity held by the five largest equity holders. The FSOC will use this information to monitor certain systemic trends for the private fund industry and to monitor borrowing practices by private funds, which "may have interconnected impacts on banks and thus the broader financial system."⁶

Section 1c requires an adviser to report information regarding the hedge funds the adviser manages, if any, including each hedge fund's investment strategies, each hedge fund's trading and clearing practices, percentage of the fund's assets managed using high frequency trading strategies and counterparty exposure. Form PF defines a "hedge fund" as any private fund that has one of the three following characteristics: a performance fee that takes into account market value (instead of only realized gains), high leverage or short selling.⁷ In the Release, the SEC states that this information will enable the FSOC to monitor systemic risk that could be transmitted through counterparty exposure, track how different strategies are affected by and correlated with different market stresses, and follow the extent of private fund activities conducted away from regulated exchanges and clearing systems.

Section 2 – Large Hedge Fund Advisers

Large Hedge Fund Advisers must complete Section 2, which elicits information designed to assist the FSOC in monitoring and assessing the extent to which stresses at hedge funds could have systemic implications. Section 2a of Form PF requires certain aggregate information about hedge funds managed by the adviser, including the value of assets invested on a long and short basis in different types of securities and commodities; the duration, weighted average tenor or 10-year bond equivalent of fixed income holdings; the value of turnover of asset classes; and a geographical breakdown of investments held by the hedge funds. This information is designed to assist the FSOC in monitoring asset classes in which hedge funds may be significant investors and trends in hedge

funds' exposure. This information also will allow the FSOC to identify concentrations in particular asset classes or geographic regions.

Section 2b requires a Large Hedge Fund Adviser to report information about each hedge fund it advises that has a net asset value of at least \$500 million as of the end of any month in the prior fiscal quarter. Much of the information requested in Section 2b is the same as that requested in Section 2a, but on an individual fund basis. However, Section 2b also requests information about portfolio liquidity and cash holdings, concentration, base currency, collateral practices, exposure to credit counterparties and a fund's total notional derivatives exposure. Section 2b also requires certain risk metrics data and financing information, including a breakdown of the fund's secured and unsecured borrowing, the value of collateral and credit support, and the types of creditors. Finally, Section 2b requires information on a fund's investor composition and liquidity, and side pocket and gating requirements. The SEC asserts that the information in Section 2 is relevant to a fund's interconnectedness and leverage, which are factors the FSOC considers in making a determination to designate a nonbank financial company for FRB supervision under the Dodd-Frank Act.

Section 3 – Large Liquidity Fund Advisers

A Large Liquidity Fund Adviser must report certain information for each liquidity fund it manages in Section 3. Form PF defines a "liquidity fund" as any private fund that 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 for investors. The information required to be reported relates to valuation, liquidity, assets by type, borrowing practices and whether the fund is managed in compliance with Rule 2a-7 under the Investment Company Act of 1940. Section 3 also requires information about the fund's investors, including concentration of the fund's investor base and the liquidity of ownership interests.

The information in Section 3 is meant to assist the FSOC in assessing the risks undertaken by liquidity funds, their susceptibility to runs and how their investments might pose systemic risks either among liquidity funds or through "contagion" to registered money market funds. The

information also is intended to help the FSOC monitor leverage practices among liquidity funds and the interconnectedness of securities lending programs. These are factors the FSOC must consider in making a determination to designate a nonbank financial company for FRB supervision under the Dodd-Frank Act.

Section 4 – Large Private Equity Advisers

Large Private Equity Advisers are required to complete Section 4. A "private equity fund" is defined in Form PF as any 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.⁸

Section 4 requires a Large Private Equity Adviser to report certain information about each private equity fund it manages, including, among other things, information about guarantees of portfolio company obligations, the leverage of the portfolio companies the fund controls, the total amount of borrowings of the fund's controlled portfolio companies, the identities of institutions providing bridge financing to controlled portfolio companies and the amount of the financing, information about co-investments by related persons in any of the fund's portfolio companies, and a breakdown of a fund's investments by industry and geography. The Release explains that most of the reporting in Section 4 relates to portfolio companies because the SEC believes that leverage in private equity structures generally is incurred at the portfolio company level.

The information in Section 4 is designed to provide the FSOC with information regarding the exposure of Large Private Equity Advisers and their funds to the risks of their portfolio companies. The information also will help the FSOC assess the potential exposure of banks and other lenders to the portfolio companies of funds managed by Large Private Equity Advisers and to monitor trends that could have systemic impact. Finally, the information will enable the FSOC to monitor global and industry concentrations among private equity funds, because concentration is one of the factors that it must consider in making a determination to designate a nonbank financial company for FRB supervision under the Dodd-Frank Act.

Aggregate Reporting

An adviser may, but is not required to, provide information regarding master-feeder arrangements and parallel fund structures in the aggregate. It also can report them separately, but must follow a consistent reporting methodology. By way of example, the Release states that an adviser may complete either a single Section 1b for all the funds in a master-feeder arrangement or a separate Section 1b for each fund in the arrangement. Aggregate reporting differs from aggregation requirements for determining whether an adviser or any fund meets a reporting threshold, which is discussed above.

Compliance Date and Burden Estimates

June 15, 2012 is the compliance date for advisers with \$5 billion in assets under management attributable to hedge funds and liquidity funds as of last day of the fiscal quarter most recently completed prior to June 15, 2012, and private equity funds as of the last day its first fiscal year to end on or after June 15, 2012. Thus, an adviser with hedge fund assets of \$5 billion as of March 31, 2012 must file its first Form PF within 60 days after June 30, 2012, while an adviser with \$5 billion in liquidity fund assets on March 31, 2012 must file within 15 days following June 30, 2012. All other advisers to private funds must comply by December 15, 2012, based on information as of December 31, 2012.

The SEC estimates the following number of hours for advisers to compile, review and electronically file the required information:

	Initial Filing	Each Subsequent Filing
Smaller Fund Advisers	40 hours	15 hours annually
Large Hedge Fund Advisers	300 hours	140 hours quarterly
Large Liquidity Fund Advisers	140 hours	65 hours quarterly
Large Private Equity Advisers	100 hours	50 hours annually

FOR MORE INFORMATION

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¹ Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisers on Form PF, Release No. IA-3308 (October 31,

2011) ("Release"). At the same time, the Commodity Futures Trading Commission (CFTC) adopted Rule 4.27 under the Commodity Exchange Act requiring commodity pool operators (CPOs) and commodity trading advisers (CTAs) registered with the CFTC to satisfy certain CFTC filing requirements with respect to private funds, should the CFTC adopt such filing requirements, by filing Form PF with the SEC, but only if such CPOs and CTAs are also registered with the SEC as investment advisers and required to file Form PF under the Advisers Act.

² Rule 204b-1 requires advisers to calculate the value of private fund assets under management in accordance with the method of calculating regulatory assets under management on Form ADV. This calculation measures assets under management gross of outstanding indebtedness and other accrued but unpaid liabilities.

³ While an adviser must combine liquidity fund and registered money market assets for purposes of determining whether it is a Large Liquidity Fund Adviser, it is only required to report information on Form PF about the unregistered liquidity funds.

⁴ A "parallel fund structure" is a structure in which one or more private funds pursue substantially the same investment objective and strategy and invest side by side in substantially the same positions as another private fund.

⁵ A related person is "separately operated" if the adviser is not required to complete Section 7.A. of Schedule D of Form ADV with respect to the related person.

⁶ Release at 74.

⁷ Solely for purposes of Form PF, a commodity pool that is reported or required to be reported on Form PF is treated as a hedge fund.

⁸ The terms "real estate fund," "venture capital fund" and "securitized asset fund" also are defined in Form PF.