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## Dodd-Frank Act Rulemaking — SEC and CFTC Release Joint Final Rules Relating to Form PF

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On October 31, 2011, the Securities and Exchange Commission (the "SEC") and the Commodity Futures Trading Commission (the "CFTC") jointly released final rules implementing Sections 404 and 406 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which authorize the SEC to implement reporting requirements for federally registered investment advisers (or investment advisers that are required to be federally registered) with respect to the private funds<sup>1</sup> that they manage. The information that will be collected pursuant to the final rules will be reported on a confidential basis on Form PF. The effective date for the new rules is March 31, 2012, with the reporting requirements subject to a two-stage phase-in period for compliance beginning June 15, 2012, for the very largest private fund advisers.

### Who needs to file and when?

Under the final rules, Form PF must be filed periodically by an investment adviser if it (i) is registered or required to register with the SEC; (ii) advises one or more private funds; and (iii) had at least \$150 million in regulatory assets under management attributable to private funds as of the end of its most recently completed fiscal year (such an adviser, a "PF Adviser"). A commodity pool operator ("CPO") or a commodity trading advisor ("CTA") that is also a PF Adviser is required to file Form PF with respect to any commodity pool that is a private fund and may file Form PF with respect to any commodity pool that is not a private fund. By filing Form PF for these commodity pools, a CPO will be deemed to have satisfied certain filing requirements for these pools under the CFTC's regulatory regime should the CFTC adopt such requirements.

Most PF Advisers are required to complete and file Form PF only once per fiscal year and are only required to complete Section 1 of Form PF. However, the final rules require the following three types of "Large Private Fund Advisers" to complete certain additional sections of Form PF (with large hedge fund advisers and large liquidity fund advisers required to file Form PF on a quarterly basis): (a) a PF 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 (a "large hedge fund adviser"); (b) a PF Adviser 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 (a "large liquidity fund adviser"); or (c) a PF Adviser having at least \$2 billion in regulatory assets under management attributable to private equity funds as of the last day of the adviser's most recently completed fiscal year (a "large private equity fund adviser").

Form PF uses the "gross" definition of "regulatory assets under management" that the SEC recently adopted in connection with amendments to Form ADV. In calculating regulatory assets under management for the purposes of determining the reporting thresholds, the adviser must aggregate (i) assets of managed accounts that pursue substantially the same investment objective and strategy and invest in substantially the same positions as a private fund managed by that adviser, unless the value of those accounts exceeds the value of the private funds with which they are managed; and (ii) assets of private funds advised by any of the adviser's related persons other than related persons that are "separately operated."<sup>2</sup>

### *Hedge Funds*

Form PF defines "hedge fund" broadly to include any private fund (a) with respect to which a performance fee may be paid that takes into account market value (as opposed to only realized gains), (b) that is or may become highly leveraged<sup>3</sup> or (c) that does or may engage in short selling (other than short selling that hedges currency exposure or manages duration), but excluding securitized asset funds.<sup>4</sup> The final rules clarify that clause (a) relates only to fees or allocations that may be paid to an adviser or its related persons and excludes performance fees that take into account unrealized gains solely for the purpose of reducing such fees or

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allocations to reflect net unrealized losses. Solely for purposes of Form PF, a commodity pool is treated as a hedge fund. Large hedge fund advisers are required to provide additional information on Section 2 of Form PF and must file Form PF on a quarterly basis (within 60 days of fiscal quarter-end). Smaller hedge fund advisers need only complete Section 1 of Form PF, filing annually within 120 days of fiscal year-end.

#### *Liquidity Funds*

Form PF defines "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. Liquidity fund advisers must aggregate liquidity fund and registered money market fund assets for purposes of determining whether the large liquidity fund adviser threshold is met. Large liquidity fund advisers are required to provide additional information on Section 3 of Form PF and must file within 15 days of fiscal quarter-end. Smaller liquidity fund advisers need only complete Section 1 of Form PF, filing annually within 120 days of fiscal year-end.

#### *Private Equity Funds*

Form PF defines "private equity fund" as any private fund that is not a hedge fund, liquidity fund, real estate fund,<sup>5</sup> securitized asset fund or venture capital fund<sup>6</sup> and that does not provide investors with redemption rights in the ordinary course. Large private equity fund advisers are required to provide additional information on Section 4 of Form PF and must file within 120 days of fiscal year-end. Smaller private equity fund advisers need only complete Section 1 of Form PF, filing annually within 120 days of fiscal year-end.

#### *Fund-of-funds and Sub-advisors*

For purposes of both the reporting thresholds and responding to questions on Form PF, assets invested in the equity of other private funds may be excluded, but not any related liabilities incurred in connection with such investment. In addition, if a private fund invests substantially all of its assets in the equity of other private funds and otherwise holds only cash or cash equivalents and instruments to hedge currency risk, only section 1b of Form PF need be completed with respect to such fund. With respect to sub-advised funds, only one adviser is required to report information on Form PF with respect to that fund (usually the adviser that completes section 7.B.1. of Schedule D to Form ADV, unless such adviser is not a PF Adviser).

#### *Two-stage Phase In*

PF advisers who have (a) more than \$5 billion in regulatory assets under management attributable to hedge funds, (b) more than \$5 billion in regulatory assets under management attributable to liquidity funds, or (c) more than \$5 billion in regulatory assets under management attributable to private equity funds must begin filing Form PF with the first fiscal quarter or year ending on or after June 15, 2012. Other PF Advisers must begin filing Form PF with the first fiscal quarter or year ending on or after December 15, 2012.

#### What must be disclosed?

Form PF requires the following (items marked with an asterisk (\*) represent new requirements compared to the proposed form):

##### *Section 1a*

- Basic identifying information regarding the PF Adviser, such as its name and the name of any of its related persons whose information is also included on the form and its large trader identification number,\* if any.
- Aggregate information relating to all private funds managed by the PF Adviser such as the portion of gross (i.e., regulatory) and net assets under management attributable to certain types of private funds.

##### *Section 1b*

- Basic information relating to each private fund the adviser manages (with certain exceptions for master-feeder and parallel fund structures).
- Information on each private fund's gross and net assets and the aggregate notional value of its derivative positions.
- Basic information about the fund's borrowings, including whether the creditor is based in the United States and whether it is a financial institution.
- Information relating to the concentration of private funds' investor bases, such as the number of beneficial owners of the fund's equity and the percentage of the fund's equity held by the five largest equity holders. With respect to non-U.S. investors about which the adviser does not have and cannot reasonably obtain beneficial ownership information, the adviser must report only the size of the ownership interest with respect to which such data is not available.\*
- A breakdown of assets and liabilities using categories based on the fair value hierarchy established under US GAAP.\*
- Percentage beneficial ownership by certain types of investors.\*
- Information concerning the value of the fund's investments in other private funds and concerning certain

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## Related Services

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## Related Publications

[Investment Management Alert - Dodd-Frank Act Rulemaking: SEC Approves Final Version of Form PF 10/27/2011](#)

[Investment Management Alert - Reminder: Rule 13h-1 \(the Large Trader Reporting Rule\) Compliance Date is Dec. 1, 2011; Effective Date Was Oct. 3, 2011 10/11/2011](#)

[Dodd-Frank Rulemaking: SEC Releases Final Rules Clarifying Certain Registration Exemptions, Planning for Transition of Mid-Sized Investment Advisers 9/28/2011](#)

[Why Is it So Hard to Launch a Hedge Fund Today? 8/19/2011](#)

[Investment Management Alert - New FINRA Rule 1230\(b\)\(6\): Operations Professionals Must Register and Pass an Examination 7/26/2011](#)

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[Dodd-Frank Act Rulemaking - SEC Issues Order Adjusting Dollar Amount Thresholds For Qualified Client Rule Under the Advisers Act 7/19/2011](#)

[Investment Management Alert - Dodd-Frank Act Rulemaking: SEC Releases Final Rules Relating to Registration and Oversight of Investment Advisers 6/24/2011](#)

[Investment Management Alert - FINRA Rule 5131: Spinning and Market Orders Provisions Delayed to September 26, 2011 5/25/2011](#)

[Investors Fight Back 5/19/2011](#)

[Investment Management Alert: Dodd-Frank Act Rulemaking – SEC Proposes Revisions to "Qualified Client" Rule Under the Advisers Act 5/18/2011](#)

[Investment Management Alert - FINRA Rule 5131: What Fund Managers and Broker-Dealers Should Think About Before May 27, 2011 4/12/2011](#)

[Learning Curve: Negotiating Section 2\(a\)\(iii\) In The ISDA Master 3/28/2011](#)

[Hedge, PE and VC Funds, Be Warned: Insurance Companies Disclaim Coverage 3/23/2011](#)

[Investment Management Alert: Significant Legislative and Regulatory Developments in 2010;](#)

managed accounts.\* As discussed above, advisers are not required to aggregate parallel managed accounts (i.e., managed accounts that pursue substantially the same investment objective and strategy and invest in substantially the same positions as a private fund managed by that adviser) with their private funds for reporting purposes, but are still required to report in Section 1b of Form PF the total amount of parallel managed accounts related to each private fund reported on Form PF.

[Q1 and Q2 2011 Checklist 3/9/2011](#)

[The Alternative Investment Fund Managers Directive: Impact on U.S. Fund Managers 2/15/2011](#)

[Investment Management Alert: Dodd-Frank Act Rulemaking — SEC and CFTC Release Proposed Rule Relating to Private Fund Systemic Reporting 2/1/2011](#)

[Fall/Winter 2011 Investment Management Group Client Update 1/13/2011](#)

[Derivatives: One Key Focus of the Dodd-Frank Wall Street Reform and Consumer Protection Act 9/2/2010](#)

Of note, relative to the proposed form, the final Form PF omits change in net asset value, allows advisers to report performance gross and net of management fees and incentive fees and allocations (rather than gross and net of incentive fees and allocations only), and makes reporting of monthly and quarterly performance results mandatory only when performance results are already calculated with that frequency.

#### *Section 1c (all hedge funds)*

- Information relating to the hedge funds' investment strategies, use of computer-driven trading algorithms, significant trading counterparty exposures (including identity of counterparties), and trading and clearing practices.

Of note, relative to the proposed form, questions regarding counterparty exposures have been modified for clarity and to more closely align the requirements with information already determined in connection with trading arrangements and less granular disclosure of subclasses in connection with trading and clearing practices is now required.

#### *Section 2 (large hedge fund advisers)*

- Information regarding exposures by asset class, geographical concentration (regions rather than countries\*) and turnover (as a value of transactions rather than a rate\* and in certain asset classes only\*).
- With respect to each hedge fund with a net asset value of at least \$500 million, information relating to the value of such funds' investments, leverage, risk profiles, liquidity, base currency,\* risk metrics other than VaR\* and derivative exposures (including net mark-to-market value of uncleared derivatives positions\*).

Of note, relative to the proposed form, advisers have the option of reporting weighted average tenor or 10-year bond equivalents in place of duration and less detail is required with regard to a number of items.

#### *Section 3 (large liquidity fund advisers)*

- Information relating to the value of fund portfolios, risk profile and the extent to which the managed funds have a policy of complying with all or any aspects of Rule 2a-7 under the Investment Company Act of 1940.<sup>7</sup>

#### *Section 4 (large private equity fund advisers)*

- Information relating to leverage incurred by portfolio companies, guarantees of portfolio company obligations, the use of bridge financing, payment-in-kind or zero coupon borrowing by portfolio companies,\* co-investments by related persons and investments in financial institutions.

Of note, relative to the proposed form, the information required is intended to more closely align with the information readily available regarding portfolio companies.

#### *Section 5 (temporary hardship exemption)*

- Must be filed within one (1) business day of a missed filing deadline.

#### *General Requirements and Methodologies*

The final rules no longer require that an authorized individual affirm "under penalty of perjury" that the statements in Form PF are "true and correct." PF Advisers are now permitted to rely on their own internal methodologies used when reporting to advisory clients when reporting on Form PF, unless directly contradicted by the instructions to Form PF.

#### Are Form PF filings publicly available?

No, Form PF filings will not be publicly available. Form PF will be submitted to the SEC electronically through the Form PF filing system on the Investment Adviser Registration Depository website ([www.iard.com](http://www.iard.com)). The information reported on Form PF will generally be exempt from FOIA disclosure. The SEC intends to require that any federal department, agency or self-regulatory organization with which information is shared must represent that it has controls in place designed to ensure that the use and handling of Form PF data is strictly in accordance with the confidentiality protections established in Dodd-Frank. The SEC is evaluating its internal controls and systems in place for the use and handling of Form PF data, and depending on the progress toward the development and deployment of such controls and systems, will consider whether to delay the compliance date for Form PF.

#### What are the next steps?

While there still appear to be certain interpretive ambiguities with respect to certain Form PF reporting requirements (e.g., whether and when advisers are required to aggregate assets of different types of private funds<sup>8</sup>), the final rules appear to represent thorough consideration of public comments on Form PF by the SEC

and CFTC. The requirements set forth in the final rules generally represent more favorable treatment for private fund advisers than those requirements set forth in proposed rules relating to Form PF that were released in January 2011. Nevertheless, for many advisers, Form PF will still require significant time and attention by multiple employees and service providers to complete.

To prepare for possible reporting requirements under the final rules, advisers should evaluate (based on regulatory assets under management, fund type(s) and other relevant considerations) the filing deadlines and disclosure requirements to which they are likely to be subject next year. Each reporting adviser's Chief Compliance Officer, or other supervisory personnel responsible for administering the adviser's obligations under the final rules, should begin conferring with the adviser's Chief Financial Officer, Chief Operating Officer, custodian(s), administrator, and other relevant service providers and personnel to determine available resources and assign section-by-section responsibilities and deadlines for preparation of Form PF. The Chief Compliance Officer (or other responsible supervisor) will likely find an annotated Form PF template or matrix helpful in tracking resources, responsibilities and deadlines to complete Form PF. Some advisers may wish to consider restructuring or other alternatives to minimize the disclosure burden to which they will be subject.

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The final rules may be found [here](#). Form PF may be found [here](#).

Please contact any of the attorneys listed, or any other member of Lowenstein Sandler's [Investment Management Group](#), for further information on Form PF.

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<sup>1</sup>A "private fund" is defined as "an issuer that would be an investment company, as defined in [S]ection 3 of the Investment Company Act of 1940, but for [S]ection 3(c)(1) or 3(c)(7) of that Act."

<sup>2</sup>For purposes of Form PF, a related person is "separately operated" if the adviser is not required to complete section 7.A. of Schedule D to Form ADV with respect to such related person.

<sup>3</sup>For such purposes, high leverage means borrowing an amount in excess of one-half of such private fund's net asset value (including any committed capital) or having gross notional exposure in excess of twice such private fund's net asset value (including any committed capital).

<sup>4</sup>A "securitized asset fund" is defined as a private fund whose primary purpose is issuing asset backed securities and whose investors are primarily debt holders.

<sup>5</sup>A "real estate fund" is defined as a private fund that is not a hedge fund, that does not provide investors with redemption rights in the ordinary course and that invests primarily in real estate and real estate-related assets.

<sup>6</sup>A "venture capital fund" is defined by reference to Rule 203(l)-1 of the Advisers Act finalized in July 2011 providing an exemption from registration for venture capital funds.

<sup>7</sup>As noted in the final rules, Rule 2a-7 is designed "to ensure, among other things, that money market funds' investing remains consistent with the objective of maintaining a stable net asset value."

<sup>8</sup>Advisers should note that, while the final rules require an adviser to aggregate the assets of different types of private funds in order to determine whether the adviser surpasses the \$150 million reporting threshold for the purposes of the final rules, the final rules (despite an implicit statement to the contrary in the SEC's initial press release announcing the adoption of the final rules) do not appear to require such aggregation in order to determine the applicability of any other reporting thresholds discussed in this summary.

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