Client Alert

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SEC Report: Private Fund Assets Grew by 25 Percent over Past Two Years; Private Fund Leverage Revealed

By Jay G. Baris

The SEC's "Private Funds Statistics" report, published October 16, 2016, reveals that the number of private funds and private fund assets has grown significantly over the past two years. The data show that private funds, as a whole, may not be as leveraged as generally believed.

The report, published by the Division of Investment Management's Risk and Examinations Office (REO), summarizes a treasure trove of private fund statistics and trends based on data mined from Form PF and Form ADV filings from the first quarter of 2013 through the fourth quarter of 2014.

The report paints a picture of rapid expansion of the number of private funds, their assets under management, and the number of private fund advisers over the past two years. Only SEC- registered investment advisers with assets under management exceeding $150 million are required to report on Form PF. Non-reporting advisers and state-registered advisers are not required to report this information. Thus, the entire picture may not be complete.

Here are some interesting statistics:

Private funds and private fund advisers.

- The number of private funds managed by registered investment advisers grew by more than 20 percent, to 24,725 from 20,573.
- The number of registered advisers to these funds increased by more than 10 percent, to 2,694 from 2,433.
- Aggregate private fund gross asset value (GAV) grew by more than 24 percent, to $9.96 trillion from $8 trillion.
- Aggregate private fund net asset value increased by 26 percent, to $6.7 trillion from $5.3 trillion.

Borrowings. Aggregate borrowings by private funds remained relatively constant over the past two years. Expressed as a percentage of GAV, aggregate borrowings as of December 31, 2014, were:

- Securitized Asset Funds - 48 percent

- Qualifying Hedge Funds - 38.3 percent
- Hedge Funds - 36.9 percent
- Real Estate Funds – 13.7 percent

Fund and adviser domiciles. As of December 31, 2014:

- The United States and the Cayman Islands are the most popular homes for private funds, accounting for 87 percent of all private fund assets.
- “Qualifying Hedge Funds” preferred the Cayman Islands (55.4 percent) to the United States (31.5 percent). Qualifying Hedge Funds are hedge funds advised by “Large Hedge Fund Advisers” and have net assets of at least $500 million, individually or in combination with feeder funds and “parallel funds.” Large Hedge Fund Advisers have at least $1.5 billion in hedge fund assets under management.
- Private equity funds, on the other hand, preferred the United States domicile (63.3 percent) to the Cayman Islands (30.7 percent).
- Private fund advisers were located primarily in the United States (89.8 percent), followed by the U.K. as a distant second (6.5 percent).

Beneficial ownership of private funds. As of December 31, 2014, private funds were primarily owned by other private funds:

- More than 20 percent of the total beneficial ownership of private funds was held by other private funds
- State or municipal government pension plans (12.8 percent), pension plans (12.5 percent) U.S. individuals (11.0 percent) and non-profits (10.3 percent) made up the other major categories of private fund beneficial owners.

Derivatives. The data show that the notional amount of derivatives used by private funds increased over the past two years, but the aggregate derivative notional value, as a percentage of aggregate NAV, decreased during the same period. It is not clear what part of the aggregate derivative notional amounts are attributable to hedging activities.

- Aggregate derivative notional amounts increased to approximately $14.6 trillion from $13.3 trillion for hedge funds.
- Aggregate derivative notional amounts, as a percentage of aggregate NAV, for hedge funds decreased to 429 percent from 510 percent for hedge funds.
- Across all private funds, aggregate derivative notional amounts decreased to 220.8 percent from 255.6 percent.

High-frequency trading. As of December 31, 2014:

- The number of hedge funds using high-frequency trading (HFT) strategies for 100 percent or more of their NAV increased from 15 to 28.
- The number of hedge funds using some HFT strategies decreased from 53 to 45.
- The number of hedge funds using no HFT strategies increased to 7,155 from 5,919.

Industry concentration. The report indicates a trend toward less industry exposure concentration among the 20 largest hedge fund advisers but a level trend with respect to assets under management.

- As of December 2014, the net assets managed by the top 20 hedge fund advisers increased to 30.2 percent of total hedge fund net assets compared to 29.2 percent in January 2013.
- The gross notional exposure of the top 20 hedge fund advisers, however decreased to 53.7 percent in December 2014 from 62.0 percent in January 2013.

Exposures. The data also reflect trends in asset class exposures of hedge funds. For example, from January 2013 to December 2014:

- Equity category exposure increased by approximately 50 percent, to $1.5 trillion from $1.0 trillion.
- Managed futures/CTA category exposure increased by two thirds, to $90 billion from $54 billion.
- Fund of funds investments nearly doubled to $49 billion from $25 billion.
- As a percentage of NAV, these exposures remained relatively constant, except in the fund of funds category, which increased to 1.8 percent from 1.2 percent.

Liquidity. Portfolio liquidity of Qualifying Hedge Funds as a percentage of aggregate NAV from January 2013 to December 2014 remained fairly constant. As of December 2014:

- One-day liquidation period was 29.2 percent, while the one-year liquidation period was 90.8 percent.

Our take. It may be premature to draw broad conclusions until the data are further analyzed. Nonetheless, the data provide some interesting topics for discussion. First, private fund assets and the number of private fund advisers have grown over the past two years. Second, the data suggest that private funds are not as leveraged as some people (or bank regulators) may believe. Third, the fact that the SEC has this information should alleviate the concerns of the federal banking regulators that the SEC lacks the tools to assess and monitor systemic risk presented by asset managers and the private funds they advise.

We hope that this report and future reports help resolve the uncertainty that has led to cries for additional burdensome regulation, which likely would increase costs to investors while providing limited additional protection to investors and the financial system.

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Contact:

Jay G. Baris
(212) 468-8053
jbaris@mofo.com

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