

February 1, 2022

SEC Proposes Significant Amendments to Private Fund Reporting

Proposed Amendments to Form PF Are Aimed at Enhancing FSOC's Ability to Assess Systemic Risk and Improving the SEC's Oversight of Private Fund Advisers and Investor Protection Efforts

SUMMARY

On January 26, 2022, the Securities and Exchange Commission (the "SEC") voted 3 to 1¹ (Commissioner Peirce dissenting) to propose certain amendments to Form PF, the confidential reporting form for certain SEC-registered investment advisers to hedge funds, private equity funds and certain other private funds. The proposed amendments would represent a substantial expansion of the Form PF reporting requirements for private fund advisers, including requiring real-time reporting for specified matters that, in certain cases, appear to have only a limited relationship to the form's original purposes under the Dodd-Frank Act² to provide the Financial Stability Oversight Council ("FSOC") with sufficient data and insight into the private fund industry to monitor systemic risk. Indeed, the SEC's release expressly notes that the proposed amendments are not limited to improving FSOC's ability to monitor systemic risk and are designed to collect additional data for the SEC's use in its regulatory programs, including examinations, investigations and investor protection efforts relating to private fund advisers.³

As proposed, the amendments would:

- (1) require new reporting of certain events for both large hedge fund advisers and private equity advisers within one business day of the occurrence of a reporting event – a meaningful acceleration from the form's existing quarterly or annual reporting requirements;
- (2) add new questions and amend others in order to provide the SEC with a more detailed understanding of certain practices of large private equity advisers and to collect more data predominantly related to perceived areas of risk and conflicts of interests;
- (3) decrease the reporting threshold for large private equity advisers from \$2 billion to \$1.5 billion in private equity fund assets under management; and

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- (4) require large liquidity fund advisers to report substantially the same information that money market funds would report on Form N-MFP (which the SEC has also proposed amending, as discussed [here](#)).⁴

The SEC is seeking comment from the public on the proposed amendments, including responses to 120 specific questions included in the Release. Consistent with Chairman Gensler’s approach on several other recent rulemaking initiatives, comments are due only 30 days after the proposed amendments are published in the Federal Register.

BACKGROUND

According to the Release, in the almost 10-year period that the SEC has been analyzing information collected on Form PF since its adoption, “the private fund industry has grown in size and evolved in terms of business practices, complexity of fund structures, and investment strategies and exposures”.⁵ In light of these changes, the SEC and FSOC have identified “significant information gaps and situations” where more timely and detailed information would enhance their respective oversight of the private fund industry and potential systemic risk within it.⁶ In addition, the SEC has cited its experiences with recent market events – such as the turmoil caused by the COVID-19 pandemic in March 2020 and the market volatility in certain stocks in January 2021 – as highlighting the importance of receiving timely and detailed information on market participants.⁷ Accordingly, the proposed amendments are designed in part to enhance FSOC’s monitoring and assessment of systemic risk and to collect additional data for the SEC to use in its regulatory programs.⁸

At the open meeting regarding the proposed amendments, Commissioner Peirce voted against the proposal. Describing her objections to the proposed amendments as “fundamental”, Commission Peirce emphasized that the purpose of Form PF is to facilitate FSOC in its monitoring of systemic risk and stated that the SEC’s use of Form PF information for its regulatory programs is “ancillary” to such underlying purpose.⁹ Commissioner Peirce commented that the proposed amendment to require current reporting within one business day of the occurrence of a reporting event “would distend Form PF into a tool for government to micromanage private fund risk management”.¹⁰

OVERVIEW OF THE PROPOSED AMENDMENTS

Current Reporting

Current Form PF requires a private fund adviser to file Form PF quarterly or annually, depending on the characteristics of the reporting fund.¹¹ If amended as proposed, Form PF would require private fund advisers to file a current report within one business day of certain enumerated reporting events.

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For all large hedge fund advisers that have to file a Form PF, such reporting events for qualifying hedge funds¹² would include:

- **Investment loss** equal to or greater than 20% of the reporting fund's most recent net asset value over a rolling 10-business-day period;
- **Significant margin and default events**, including (i) a cumulative increase in margin of more than 20% of the reporting fund's most recent net asset value over a 10-business-day period, (ii) a margin default by the reporting fund or inability to meet a call for margin, collateral, or an equivalent (taking into account any contractually agreed cure period) and (iii) a margin default by a counterparty;
- **Material changes in prime broker relationships**, including material changes to the reporting fund's ability to trade or a termination of the prime brokerage relationship as a result of default or breach of the prime brokerage agreement;
- **Decline in unencumbered cash** by more than 20% of the reporting fund's most recent net asset value over a rolling 10-business-day period;
- **Significant disruption or degradation of key operations**, i.e., a 20% disruption or degradation of normal volume or capacity. Key operations would mean operations necessary for (1) the investment, trading, valuation, reporting and risk management of the reporting fund and (2) the operation of the reporting fund in accordance with federal securities laws and regulations, whether as a result of an event at the reporting fund, the applicable adviser or other service provider to the reporting fund;¹³ and
- **Certain events associated with withdrawals and redemptions**, including (i) if an adviser 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) and (ii) if the reporting fund is unable to satisfy redemptions or suspends redemptions for more than five consecutive business days.

For all private equity fund advisers that have to file a Form PF, such reporting events for private equity funds¹⁴ would include:

- **Completion of an adviser-led secondary transaction**, i.e., any transaction initiated by the adviser or its related persons that offers private fund 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;¹⁵
- **Implementation of a general partner clawback**, i.e., any obligation of the general partner, its related person or their respective owners or interest holders to restore or otherwise return performance-based compensation¹⁶ to the fund pursuant to the fund's governing agreements;
- **Implementation of a limited partner clawback (or giveback)** in excess of an amount equal to 10% of the reporting fund's aggregate capital commitments; and
- Certain other events, including (i) **removal of a fund's general partner**, (ii) **termination of a fund's investment period** or (iii) **termination of a fund**.

Additional Reporting by Large Private Equity Advisers

In addition, the proposed amendments propose to add new questions to Section 4 of Form PF – a section which requires large private equity advisers to report additional information regarding private equity funds – which would collect information on topics such as:

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- Private equity funds investment strategies, which would include private credit (and associated sub-strategies such as distressed debt, senior debt, special situations, etc.), private equity (and associated sub-strategies such as early stage, buyout, growth, etc.), real estate, annuity and life insurance policies, litigation finance, digital assets, general partner stakes investing, among others;
- Restructurings or recapitalizations of the reporting fund's portfolio companies;
- Investments in different levels of a single portfolio company's capital structure by related funds;
- Whether a reporting fund borrows or has the ability to borrow at the fund level as an alternative or complement to the financing of portfolio companies;
- Whether an adviser or any of its related persons provide financing or otherwise extend credit to any portfolio company in which the reporting fund invests and the amount of such financing or extension of credit;
- Floating rate borrowings of controlled portfolio companies ("CPCs"); and
- How many CPCs a reporting fund owns.

The proposed amendments further propose to amend three existing questions in Section 4 in order to provide more granular information on (i) the nature of reported events of default, (ii) the identity of institutions providing bridge financing to an adviser's CPCs and the amount of such financing and (iii) the geographical breakdown of a private equity fund's greatest country exposures based on a percent of net asset value.

The Release states that these proposals are designed to enhance the SEC's understanding of certain practices of private equity advisers and to improve data collection. In particular, the Release notes that Form PF does not currently collect data on private equity fund strategies and that the SEC believes that it is important to begin collecting this information given the growth of the private equity industry since the form was adopted in 2011 and the diversity of strategies employed by private equity funds.¹⁷

Reporting Threshold for Large Private Equity Advisers

Under the current Form PF, a private fund adviser must complete Section 4 of the form if it has at least \$2 billion in private equity fund assets under management as of the last day of its most recently completed fiscal year. If amended as proposed, such reporting threshold would be reduced from \$2 billion to \$1.5 billion. The Release explains that the existing reporting threshold of \$2 billion in private equity fund assets under management currently captures approximately 67% of the U.S. private equity industry, as opposed to capturing approximately 75% as the \$2 billion threshold purportedly did when Form PF was adopted in 2011.¹⁸ At the open meeting on the proposed amendments, Commissioner Peirce expressed concerns with the SEC's reasoning and urged her fellow Commissioners to support *increasing* the reporting threshold for large private equity advisers, as opposed to decreasing it, citing, among other things, the costs to smaller private fund advisers.¹⁹

Large Liquidity Funds

Finally, the proposed amendments would amend Section 3 of Form PF, a section which pertains to how advisers to large liquidity funds report operational information and assets, along with portfolio, financing

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and investor information. According to the Release, the proposed changes are designed to improve data quality and comparability and make the certain Section 3 categories more consistent with the categories used by the Board of Governors of the Federal Reserve System (“Federal Reserve Board”) in its reports and analysis.²⁰ Specifically, the proposed amendments to Section 3 would, among other things:

- Replace the current questions that require advisers to report whether the reporting liquidity fund uses certain methodologies to compute its net asset value with a requirement for advisers to report whether the liquidity fund seeks to maintain a stable price per share and, if so, the price it seeks to maintain;
- Make certain changes to how advisers report assets and portfolio information, including requiring advisers to (i) report cash separately from other categories when reporting assets and portfolio information concerning repo collateral, (ii) provide total gross subscriptions (including dividend reinvestments) and total gross redemptions for each month of the applicable reporting period and (iii) report additional identifying information about a portfolio security, including the name of the counterparty of a repo;
- Require advisers to indicate whether a creditor is based in the U.S. and whether it is a “U.S. depository institution”, rather than a “U.S. financial institution” (as Section 3 currently provides);
- Require advisers to report whether the reporting liquidity fund is established as a cash management vehicle for other funds or accounts that the adviser or the adviser’s affiliates manage that are not cash management vehicles;
- Require advisers to report new information concerning the disposition of portfolio securities for each of the three months in the quarter; and
- Revise the definitions of “WAM” (weighted average maturity) and “WAL” (weighted average life) to include an instruction to calculate them with the dollar-weighted average based on the percentage of each security’s market value in portfolio.²¹

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ENDNOTES

- 1 The Commission is currently comprised of only four commissioners following the recent departure of Commissioner Roisman which was announced in December 2021. See Statement of Commissioner Elad L. Roisman (Dec. 20, 2021), *available at* <https://www.sec.gov/news/statement/roisman-20211220>.
- 2 Pub. L. No. 111-203, 124 Stat. 1376 (2010).
- 3 Amendments to Form PF to Require Current Reporting and Amend Reporting Requirements for Large Private Equity Advisers and Large Liquidity Fund Advisers. SEC Release No. IA-5950 (Jan. 26, 2022) (the “Release”) at 5.
- 4 *Id.* at 4-10.
- 5 *Id.* at 5-6. For example, the Release notes that (i) the value of private fund net assets reported on Form PF have more than doubled from \$5 trillion in 2013 to \$11 trillion by the end of 2020 and (ii) the number of private funds reported on Form PF has increased by nearly 70%. *Id.* at 6, n.4.
- 6 *Id.* at 6.
- 7 See *id.*, passim; see also SEC Fact Sheet, Proposed Amendments to Form PF at 1.
- 8 *Id.* at 123.
- 9 Commissioner Hester M. Peirce, Statement on Proposed Amendments to Form PF to Require Current Reporting and Amend Reporting Requirements for Large Private Equity Advisers and Large Liquidity Advisers (Jan. 26, 2022), *available at* <https://www.sec.gov/news/statement/peirce-form-pf-20220122>.
- 10 *Id.*
- 11 Specifically, advisers to hedge funds are required to file Form PF quarterly, whereas advisers to private equity funds are required to file annually.
- 12 A qualifying hedge fund is defined in Form PF as “any hedge fund that has a net asset value (individually or in combination with any feeder funds, parallel funds and/or dependent parallel managed accounts) of at least \$500 million as of the last day of any month in the fiscal quarter immediately preceding your most recently completed fiscal quarter”. Release at 6, n.7.
- 13 *Id.* at 34.
- 14 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”. Form PF: Glossary of Terms (“private equity fund”).
- 15 The SEC notes that adviser-led secondary transactions have become increasingly common in the private equity space and may present conflicts of interest that merit timely reporting and monitoring. The SEC further notes that, to the extent an increase in adviser-led secondary transactions also indicates an inability to sell portfolio companies (or to sell those companies at existing valuations) through more traditional exit avenues, transactions of this nature could be a leading indicator of a declining market, a situation that also merits timely monitoring. Release at 45-46.
- 16 Under the proposed amendments, “performance-based compensation” would mean “any allocation, payment, or distribution of capital based on the fund’s (or its portfolio investments’) capital gains and/or capital appreciation. This definition would include cash or non-cash compensation, including in-kind allocations, payments, or distributions of performance-based compensation.” *Id.* at 47, n.55.
- 17 *Id.* at 55.
- 18 *Id.* at 54.

ENDNOTES (CONTINUED)

¹⁹ Commissioner Peirce asked, “What is so magical about 75% of the industry falling within the ambit of Form PF? Was the current \$2 billion threshold chosen to reach 75%, or was 75% nothing more than the result of a \$2 billion dollar threshold?” Commissioner Peirce cautioned against what, in her view, would be setting a precedent that the SEC will “continue to reduce the threshold again and again as the addition of smaller advisers means a smaller percentage of advisers meet the reporting threshold.” Commissioner Hester M. Peirce, Statement on Proposed Amendments to Form PF to Require Current Reporting and Amend Reporting Requirements for Large Private Equity Advisers and Large Liquidity Advisers (Jan. 26, 2022), *available at* <https://www.sec.gov/news/statement/peirce-form-pf-20220122>.

²⁰ Release at 67.

²¹ *Id.* at 67-74.

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