Hogan Lovells

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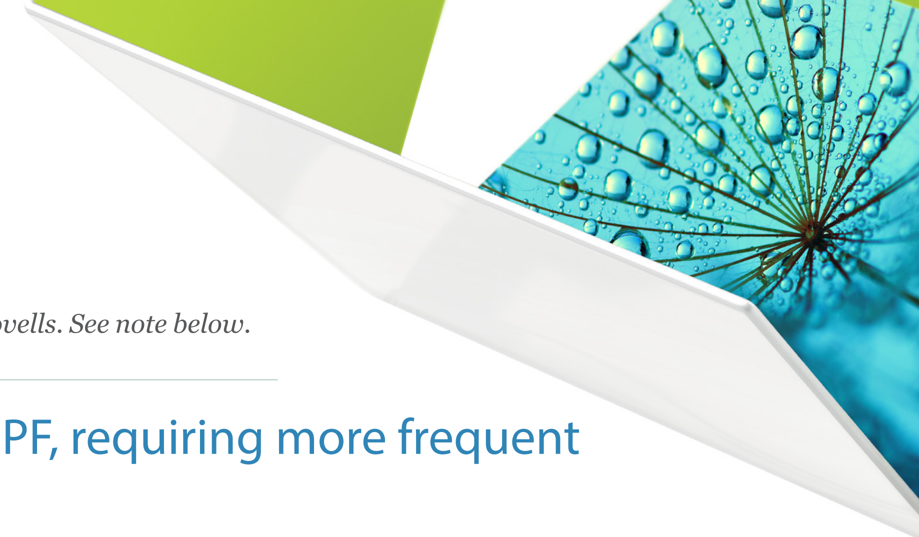

*This is a commercial communication from Hogan Lovells. See note below.*

# SEC adopts overhaul to Form PF, requiring more frequent reporting for some advisers

The U.S. Securities and Exchange Commission (SEC) adopted final amendments to Form PF, the confidential reporting form required for certain SEC-registered investment advisers (RIAs) to private funds, on 3 May 2023. The amendments, first proposed by the SEC in January 2022, mainly affect RIAs, certain large hedge funds, and private equity funds, but they impose certain quarterly material event reporting requirements by all advisers to private equity funds that are required to file Form PF. The changes, which come a decade after the form was introduced, are designed to enhance the ability of the cross-governmental Financial Stability Oversight Council (FSOC) to monitor systemic risk as well as bolster the SEC's regulatory oversight of private fund advisers and investor protection.

The amendments introduce the following requirements:

1. **New Section 6** requires quarterly reporting by all private equity fund advisers regarding the following events:
   - Adviser-led secondary transactions; and
   - When investors remove a fund's general partner (GP) or otherwise opt to terminate the investment period or terminate the fund.
2. **Amendments to Section 4** will require enhanced annual reporting by large private equity fund advisers to improve FSOC's ability to monitor systemic risk and improve the ability of both FSOC and the SEC to identify and assess changes in market trends, including as to certain GP and limited partner (LP) clawback events and additional data on fund-level borrowing.
3. **New Section 5** requires current reporting (*i.e.* as soon as practicable and no later than 72 hours) by certain large hedge fund advisers to report events that may indicate significant stress that could harm fund investors or signal risk in the broader financial system, including significant withdrawals or redemptions, extraordinary investment losses, or significant margin or default events.

In particular, the SEC pointed to the growth of private funds as a key rationale for the amendments, noting that the value of private fund net assets reported on Form PF has almost tripled in a decade – growing from $5 trillion in 2013 to nearly $14 trillion through the second quarter of 2022.[1] The amendments represent the first final action from the SEC following over a half-dozen proposed rules introduced since early 2022 that would affect private fund advisers. These regulatory proposals, including the Form PF amendments, reflect the Gary Gensler-led SEC's policy goals to enhance transparency and disclosure in respect of private funds, especially in light of the growth of the private fund industry.

The final adoption of the amendments isn't necessarily the final word on changes to Form PF. The SEC, in a joint proposal with the Commodity Futures Trading Commission (CFTC) introduced in August 2022, could adopt additional amendments later this year that would increase reporting by RIAs to private funds.

New **Sections 5 and 6** of Form PF will take effect 180 days after the date of publication in the Federal Register (not yet determined as of the date of this writing), given that the SEC believes the current and quarterly reporting

1 The SEC reports that, as of the second quarter of 2022, there were 9,733 hedge funds reported on Form PF, managed by 1,857 advisers with investment discretion over around $9.4 trillion in gross assets under management. Among those hedge fund advisers, 598 advisers met the $1.5 billion threshold for large hedge fund advisers, which oversaw 2,059 hedge funds with $7.9 trillion in gross assets under management (around 84% of all reported hedge fund assets). As of the second quarter of 2022, there were 18,987 private equity funds reported on Form PF by 1,635 advisers, with a total of $6.4 trillion in gross assets under management. Among those private equity fund advisers, 435 advisers met the $2 billion threshold for large private equity fund advisers, which oversaw 6,644 private equity funds with nearly $4.9 trillion in gross assets under management (around 77% of all reported private equity fund assets).

are critical to understanding real-time systemic risk; the amendments to the existing sections will take effect 365 days after the Federal Register publication date.

The final rule is available here.

## At a glance

| Advisor type | Definition | Prior Form PF obligations | New Form PF obligations |
|---|---|---|---|
| **Private fund adviser** | Any RIA to private funds with over $150 million in private fund regulatory assets under management.[2] | Section 1 on an annual basis (within 120 days of the end of the fiscal year). | New Section 6 quarterly reporting by advisers to private equity funds[3] of adviser-led secondaries or investor-led adviser removal or termination of fund or investment period.[4] |
| **Large private equity fund adviser** | Any RIA to private funds with over $2 billion in private equity regulatory assets under management.[5] | Sections 1 and 4 on an annual basis (within 120 days of the end of the fiscal year). | Additional reporting in Section 4 for GP clawback, LP clawback exceeding 10% of aggregate commitments, fund investment strategy, fund-level borrowing, and other items. |
| **Large hedge fund adviser** | Any RIA to hedge funds with over $1.5 billion in hedge fund regulatory assets under management. | Section 1 on an annual basis (within 120 days of the end of the fiscal year) and Section 2 on a quarterly basis (within 60 days of the end of the fiscal quarter). | New Section 5 current reporting (as soon as practicable, but no later than 72 hours[6] after the reporting event) for certain events, such as extraordinary investment losses or significant withdrawals or redemptions. |
| **Exempt advisers (including ERAs)** | Any adviser not required to register with the SEC under the Advisers Act, including "exempt reporting advisers." | No requirement. | No requirement. |

## Background

The SEC adopted **Rule 204(b)-1** under the U.S. Investment Advisers Act of 1940 (the Advisers Act) in 2011 to require the completion of Form PF, beginning in 2013, by all advisers[7] that manage one or more private funds with at least $150 million in assets, as of the last day of the RIA's most recently completed fiscal year. Form PF's rationale is to provide crucial data to policymakers to help identify systemic trends in the private fund industry and corresponding risks to U.S. financial markets.

Form PF, unlike Form ADV, is not available to the public. Form PF is generally completed within 120 days of the end of the RIA's fiscal year; many RIAs whose fiscal year mirrors the calendar year recently completed their annual reporting in 2023 at the end of April.

2 Generally, regulatory assets under management, in respect of each private fund, will be the sum of all of such fund's assets, regardless of the nature of such assets plus all uncalled capital commitments.
3 A private equity fund is 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.
4 The SEC had proposed, but ultimately rejected, current reporting for these items.
5 The SEC had proposed, but ultimately rejected, lowering the $2 billion threshold to $1.5 billion.
6 The SEC had proposed, but ultimately rejected, a deadline of one business day.
7 For all purposes, an adviser's assets under management should include not only the adviser, but all of its "related persons," certain affiliated entities that would typically include any related fund-specific general partner or manager.

Form PF is a complex disclosure form, currently with 79 discrete questions across four sections, drawing data not only from advisers and their funds, but in many cases financial data from fund portfolio companies:

- Section 1 is required by all RIAs to private funds annually;
- Section 2 is required on a quarterly basis only for "large hedge fund advisers," *i.e.*, those with at least $1.5 billion in hedge fund assets under management;
- Section 3 is required on a quarterly basis only for "large liquidity fund advisers," *i.e.*, those with at least $1 billion in liquidity fund assets under management; and
- Section 4 is required, on an annual basis, only for "large private equity fund advisers," *i.e.*, those with at least $2 billion in private equity fund assets under management. As noted below, the SEC's original proposal would have lowered this threshold to $1.5 million; the final rule retains the $2 billion threshold.

Form PF is *not required* for exempt reporting advisers (ERAs) relying on the private fund adviser exemption (under $150 million in assets under management) and/or the venture capital fund adviser exemptions or for other exempt advisers, such as private foreign advisers or advisers relying on the small business investment company (SBIC) exemption. Also, RIAs with less than $150 million of private fund regulatory assets under management (including private fund RAUM of related persons) are not subject to the Form PF reporting requirement.

## New Section 6 requires quarterly reporting by all private equity fund advisers

All private equity fund advisers will be required to make quarterly reports, within 60 days after the end of the adviser's fiscal quarter following either (i) the completion of an adviser-led secondary transaction, including the closing date and a brief description of the transaction or (ii) investor election to remove a fund's general partner or to terminate a fund's investment period or the fund itself.

Section 6 defines an "adviser-led secondary transaction" as any transaction initiated by the adviser or any of its related persons (*e.g.*, a general partner or manager of the fund) that offers private fund investors the choice to either (i) sell all or a portion of their interests in the private fund or (ii) convert or exchange all or any portion of their interests in the private fund for interests in another vehicle advised by the adviser or its related persons. Since Form PF's adoption in 2013, adviser-led secondary transactions (and other sponsor liquidity events) have grown widely throughout the industry as a way of providing additional liquidity options to fund sponsors and investors alike, especially in the later years of a fund's life cycle.

The amendments reflect the SEC's concern that the growth of the adviser-led secondaries and sponsor liquidity market can alter the liquidity in the private equity market, while acknowledging that not all secondary transactions are alike. An adviser-led secondary transaction may just as easily reflect an extension or add-on to a successful investment rather than an attempt to restructure an investment portfolio that is struggling. The SEC also noted the significant conflicts of interest involved in adviser-led secondaries, adding that quarterly reporting will allow it to monitor such transactions more effectively in fulfilling its investor protection role.

Secondly, private equity fund advisers will be required to report when a fund's investors have (with or without cause): (i) removed the adviser or an affiliate as the general partner or similar control person of a fund, (ii) elected to terminate the fund's investment period, or (iii) elected to terminate the fund, in each case as contemplated by the fund documents. Only investor-led events give rise to a reporting obligation.

Advisers will have the ability, as in Section 5, to provide an optional explanatory note about the context of any quarterly reporting events.

The SEC's initial proposal would have required current reporting, akin to that required for large hedge fund advisers in Section 5; the final amendments, however, note that quarterly reporting is sufficiently appropriate in light of the more illiquid nature of private equity funds and the longer time horizon of such funds, allowing systemic risks to present less suddenly. The proposed reporting requirements regarding GP and LP clawbacks will also be limited to large private equity fund advisers.

## Enhanced reporting by large private equity fund advisers

Finally, the SEC is amending Section 4 – for large private equity fund advisers only – to introduce additional questions designed to improve FSOC's ability to monitor risk and to enhance the SEC's understanding of certain private equity practices.

Large private equity fund advisers will now be required to report annually on the following topics:

- **GP clawback.** New Questions 82 and 83 will require advisers to report any amount of general partner clawback. The SEC defines a "general partner clawback" as any obligation of the general partner, its related persons, or their respective owners to restore or otherwise return performance-based compensation to the fund pursuant to the fund's governing agreements. This typically occurs when a fund sponsor receives excess profit as carried interest distributions early in the life of the fund, but then must later return the excess amount to investors (*e.g.*, if at the end of the fund's term, a sponsor has received more than the 20 percent of profits to which it is entitled as carried interest). Reporting events will require the adviser to provide the effective date and reason for the clawback.
- **LP clawback.** In addition, Questions 82 and 83 require the reporting of any limited partner clawback(s) exceeding 10% of the fund's aggregate capital commitments. The SEC defines a "limited partner clawback" as an obligation of a fund's investors to return all or any portion of a distribution made by the fund to satisfy a liability, obligation, or expense of the fund pursuant to the fund's governing documents. A significant LP clawback (over 10% of commitments) could indicate an event that could have a significant negative impact on a fund's investors. As with GP clawbacks, reporting will include the effective date and reason for the clawback.
- **PE fund strategies.** New Question 66 requires each fund to report its investment strategy from among several options in a drop-down menu: (i) private credit (and associated sub-strategies such as distressed debt, senior debt, special situations, etc.), (ii) private equity (and associated sub-strategies such as early stage, buyout, growth, etc.), (iii) real estate, (iv) annuity and life insurance policies, (v) litigation finance, (vi) digital assets, (vii) general partner stakes investing, and others.
- **Fund-level borrowings.** New Question 68 will require each fund, if engaged in fund-level borrowing, to provide (i) information on each borrowing or other cash financing available to the fund, (ii) the total dollar amount available, and (iii) the average amount borrowed over the reporting period. While Form PF already captures some portfolio company-level leverage, the new requirement is designed to give the SEC and FSOC clearer visibility into fund-level leverage. The requirement comes in response to more aggressive use of subscription line credit facilities by fund advisers over the last decade.
- **Events of default.** Existing Question 74 will require advisers to provide additional information about the nature of reported events of default, including as to whether such payment default is a default by the fund itself, by a controlled portfolio company, or relating to a failure to uphold terms of the applicable borrowing agreement.
- **Bridge financing to controlled portfolio companies.** Existing Question 75 requires reporting on the identity of the institutions providing bridge financing to an adviser's controlled portfolio companies and the amount of such financing. As amended, the question will also require additional counterparty identifying information (such as an LEI, if any) and if the counterparty is affiliated with a major financial institution, the name of such institution.
- **Geographic breakdown of investments.** Finally, existing Question 78 will be revised to require more precision about geographic breakdown of investments, shifting from a regional approach to a requirement that advisers report all countries (by ISO country code) to which a reporting fund has exposure of 10 percent or more of its net asset value.

In response to comments to the initial proposal, the SEC opted against lowering the threshold for "large private fund adviser" from $2 billion to $1.5 billion, in light of the regulatory burden it would place on relatively smaller advisers.[8]

8 The SEC notes that when Form PF was originally adopted, the $2 billion threshold was intended to capture 75% of the US private equity industry, based on committed capital. In early 2022, the $2 billion threshold captured about 67% of the industry, but now captures around 73%.

## New Section 5 requires 'current reporting' by large hedge fund advisers

The amendments would create a near-contemporaneous "warning system" for financial risk with respect to large hedge fund advisers by requiring such advisers to report certain events as soon as practicable – and in no case, within 72 hours of the occurrence of the event giving rise to the reporting obligation. Currently, large hedge funds are required to make Form PF reports only on a quarterly basis. While this shift creates a real-time obligation for hedge fund RIAs, the final rule relaxes somewhat the proposed requirement from one business day to 72 hours.

Among the events giving rise to the new current reporting obligation:

- **Extraordinary investment losses.** The trigger for extraordinary investment losses would be any loss equal to or greater than 20 percent of a fund's "reporting fund aggregate calculated value" (RFACV) over a rolling 10-day period, as opposed to the fund's most recent net asset value. By way of example, if a reporting hedge fund with a $1 billion RFACV loses $20 million for 10 consecutive business days or $200 million in one business day, it would require current reporting.

  Form PF will define RFACV as "every position in the reporting fund's portfolio, including cash and cash equivalents, short positions, and any fund-level borrowing, with the most recent price or value applied to the position for purposes of managing the investment portfolio." RFACV may be calculated using the adviser's (or the adviser's service providers') own methodology, providing it is consistent with information reported internally. RFACV is calculated on a net basis and not on a gross basis, and it should include all items at their most recent, reasonable estimate, which will be market-to-market for all holdings that can reasonably be marked daily.

- **Significant margin and default events.** In light of the fact that significant increases in margin, inability to meet a margin call, margin default, and default of a counterparty are strong indicators of potential market stress, each of these will be current reporting events. Advisers will be required to report increases in a fund's requirements for margin, collateral, or an equivalent based on a 20 percent threshold. In addition, advisers must report a fund's margin default or inability to meet a call for margin, collateral, or an equivalent (taking into account any contractually agreed cure period). Finally, advisers must report a margin default or failure to make any other payment (in the time and form contractually required) by a counterparty.

- **Termination or material restriction of prime broker relationship.** An adviser will be required to report if a fund terminates its prime broker or materially restricts its relationship with the prime broker, in whole or in part, in markets where that prime broker continues to be active.

- **Operations events.** The new current reporting events will also include any "significant disruption or degradation" of a hedge fund's "critical operations," whether as a result of an event at the reporting fund, the adviser or any other service provider. The SEC defines critical operations as those necessary for (i) the investment, trading, valuation, reporting, and risk management of the reporting fund or (ii) the operation of the reporting fund in accordance with federal securities laws and regulations.

  The SEC had originally proposed a threshold of 20% disruption or degradation of normal volume or capacity; while it ultimately chose not to set a precise limit to trigger this reporting event, it noted that a 20% disruption or degradation would still likely be indicative of the type of stress for which reporting may be necessary. By way of example, the SEC noted that software malfunctions or severe weather events causing widespread power outages could rise to the level of reporting event.

- **Withdrawals and redemptions.** Finally, current reporting events will include (i) large withdrawal and redemption requests, (ii) inability to satisfy redemptions or withdrawals, and (iii) suspensions of redemptions or withdrawals. The new rules require reporting if the subject hedge fund receives cumulative requests for withdrawals or redemption exceeding 50 percent of the most recent net asset value (after netting against subscriptions or other contributions from investors received and contractually committed). Notably, the 50 percent test applies to all requests, regardless of pre-existing gates or other liquidity limitations.

  Reporting will also be triggered if the hedge fund cannot satisfy redemptions (or suspends redemptions) for more than five consecutive business days.

The SEC declined to adopt as a reporting event a proposal that an adviser report a significant decline in holdings of 20 percent or more of its unencumbered cash.

Advisers will have the ability, to provide an optional explanatory note to describe in fuller detail the circumstances surrounding any current reporting.

## Awaiting additional Form PF amendments

RIAs are still awaiting further significant changes to Form PF following last August's joint SEC-CFTC proposal. RIAs who manage at least $150 million in private fund assets and are also registered with the CFTC as a commodities pool operator (CPO) or commodity trading advisor (CTA) are also required to complete Form PF, thereby giving the CFTC a regulatory role over Form PF. The collaboration is especially significant given that SEC chair Gary Gensler previously served as CFTC chair between 2009 and 2014.

The additional proposed amendments would:

- Enhance reporting of basic information about all advisers and the private funds they advise;
- Amend how all advisers report complex structures, such as master-feeder and parallel fund structures;
- Enhance reporting by large hedge fund advisers on certain "qualifying hedge funds" (*i.e.*, those hedge funds with a net asset value of at least $500 million);
- Enhance additional reporting about all hedge funds, generally; and
- Remove aggregate reporting for large hedge fund advisers.

As with the latest final amendments adopted to Form PF, the proposed SEC-CFTC amendments would affect hedge fund advisers most profoundly, though the amendments would reflect significant changes for all advisers who complete Form PF. Our in-depth summary of the joint SEC-CFTC proposal is available here.

## Conclusion

In 2022, in addition to these two proposals to amend Form PF, the SEC also introduced new potential rules on cybersecurity practices, new restrictions and regulations on private funds, enhanced disclosures and protections relating to special purpose acquisition companies (SPACs), a new framework for disclosures on environmental, social and governance (ESG) standards, and a new Rule 206-4(11) that would require certain diligence and oversight of an adviser's service providers. In addition, in November 2022, the new marketing rule took effect after a lengthy transition period from the old advertising and cash solicitation rules. So far in 2023, the SEC has proposed a new safeguarding rule that would modernize and replace the current custody rule. We anticipate that the SEC will issue additional final rules later this year.

We continue to monitor ongoing rulemaking by the SEC and other regulators who supervise private funds, and we will provide updates as additional proposals emerge and/or the SEC adopts final rules regarding these proposals.

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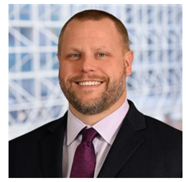

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