

SEC AND CFTC ADOPT FORM PF FOR REGISTERED INVESTMENT ADVISERS TO PRIVATE FUNDS

November 16, 2011

To Our Clients and Friends:

At the end of October, the Securities and Exchange Commission (the “SEC”) and the Commodity Futures Trading Commission (the “CFTC”) jointly adopted Form PF, the systemic risk reporting form for private fund advisers mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”). Form PF is principally designed to assist the Financial Stability Oversight Council (“FSOC”) in its assessment of systemic risk in the U.S. financial system posed by investment funds that are exempt from registration under Sections 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940 (“Private Funds”).

Only SEC-registered investment advisers with greater than \$150 million in Private Fund assets under management (“Private Fund RIAs”), including CFTC-registered commodity pool operators (“CPOs”) and commodity trading advisers (“CTAs”) that are also SEC-registered investment advisers, are required to file Form PF.

The following investment advisers are not required to file Form PF:

- non-U.S. investment advisers relying on the foreign private adviser exemption in Section 203(b)(3) of the Investment Advisers Act of 1940 (the “Advisers Act”);
- exempt reporting advisers relying on either the venture capital fund adviser exemption in Section 203(l) of the Advisers Act or the private fund adviser exemption in Section 203(m) of the Advisers Act; and
- private fund advisers that are registered with a U.S. state (because, among other things, they have less than \$100 million of assets under management).

The reporting requirements, including the frequency of filing and level of detail, depend both on the type of Private Funds managed by the Private Fund RIA—in particular, hedge funds, private equity funds and liquidity funds (unregulated money-market-type funds)—and the Private Fund RIA’s assets under management (“AUM”) relating to those types of Private Funds.

In adopting Form PF and related rules, the SEC made significant changes that should make the new reporting regime less burdensome on private equity fund advisers. For example, a large private equity fund adviser will only be required to file Form PF annually and will not be required to make filings until 120 days after the end of its fiscal year. Furthermore, the first filing for most private equity fund sponsors with a fiscal year-end of December 31 will not be due until April 30, 2013. Nevertheless, the private equity fund sponsors should begin developing the systems necessary to generate the information required by the new Form and reviewing their investment policies to assure that the funds that they manage are not characterized as hedge funds.

CLASSIFICATION OF PRIVATE FUNDS IN FORM PF

Due to the different reporting requirements for each type of Private Fund (in particular, hedge funds, private equity funds and liquidity funds), the definitions underlying the classifications are important. For purposes of Form PF, a “Hedge Fund” is any Private Fund that:

- has a performance fee or allocation calculated by taking into account unrealized gains (*i.e.*, a performance fee using mark-to-market values instead of realized gains) other than a fee or allocation the calculation of which may take into account unrealized gains solely for the purpose of reducing such fee or allocation to reflect net unrealized losses;
- may borrow an amount in excess of one half of its net asset value (including any committed capital) or may have gross notional exposure in excess of twice its net asset value (including any committed capital);
- may sell securities or other assets short other than for the purpose of hedging currency exposure or managing duration; or
- is a commodity pool.

The definition of “Hedge Fund” was changed from the proposed definition to exclude, among other things, private equity funds that might include unrealized losses in their carried interest calculation or engage in short-selling for limited foreign currency hedging purposes.

A “Private Equity Fund” is mostly defined by what it is not (*i.e.*, it does not meet the definition of a Hedge Fund, Real Estate Fund, Securitized Asset Fund, Liquidity Fund or Venture Capital Fund). The result is that a Private Equity Fund is a Private Fund that:

- if it has a performance fee, the performance fee or allocation is calculated based upon realized gains other than a fee or allocation the calculation of which may take into account unrealized gains solely for the purpose of reducing such fee or allocation to reflect net unrealized losses;
- may not borrow more than one-half of its net asset value (including any committed capital) and may not have gross notional exposure more than twice its net asset value (including any committed capital);
- may not engage in short selling of any securities or assets other than for the purpose of hedging currency exposure or managing duration;
- does not invest primarily in real estate and real estate-related assets;¹
- does not issue asset-backed securities and has no investors who are primarily debt-holders;²
- does not seek 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;³
- does not meet the definition of “venture capital fund” in Rule 203(l)-1 of the Advisers Act; and
- does not provide investors with redemption rights in the ordinary course.

As noted above, the SEC narrowed the definition of “Hedge Fund” due to the concerns expressed by many commentators concerning its breadth. However, under certain circumstances, a Private Fund which normally would be viewed as a “private equity fund” or a “real estate fund” in the market could still be considered a Hedge Fund for purposes of Form

¹ A “Real Estate Fund” is a Private Fund that: (i) is not a Hedge Fund; (ii) does not provide investors with redemption rights in the ordinary course; and (iii) invests primarily in real estate and real estate assets.

² A “Securitized Asset Fund” is any Private Fund that is not a Hedge Fund and that issues asset-backed securities and whose investors are primarily debt-holders.

³ A “Liquidity Fund” is 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.

PF if the Private Fund may engage in any short sales other than for the limited purposes described above or may borrow in excess of the threshold noted above. The SEC clarified, however, that a Private Fund would not be considered a Hedge Fund solely because its organizational document failed to prohibit it from engaging in short-selling or incurring debt over a set amount if the Private Fund did not in fact engage in those activities and a reasonable investor would understand, based on the Private Fund's offering documents, that the fund will not engage in these practices.

FORM PF: LARGE VERSUS SMALL PRIVATE FUND ADVISERS

Three categories of Private Fund RIAs are subject to enhanced reporting requirements:

- a Private Fund RIA that has at least \$1.5 billion in AUM attributable to Hedge Funds (a "Large Hedge Fund Adviser");
- a Private Fund RIA that has at least \$2 billion in AUM attributable to Private Equity Funds (a "Large Private Equity Fund Adviser"); and
- a Private Fund RIA that has at least \$1 billion in AUM attributable to Liquidity Funds (a "Large Liquidity Fund Adviser").

Large Hedge Fund Advisers, Large Private Equity Fund Advisers and the Large Liquidity Fund Advisers (collectively, "Large Private Fund Advisers") are required to fill out specific sections of Form PF that are applicable to the types of funds they manage. Private Fund RIAs who engage in other investment strategies including venture capital fund managers and real estate fund managers, even those with in excess of \$1 billion under management, are not subject to these enhanced reporting requirements.

CALCULATING AUM

The Proposed Rules require a Private Fund RIA to determine whether it is a Large Private Fund Adviser by calculating its AUM attributable to Hedge Funds and Liquidity Funds on a monthly basis and its AUM attributable to Private Equity Funds on an annual basis. This AUM attributable to a Private Fund is the regulatory assets under management (as defined under Form ADV) attributable to such Private Fund.

The AUM attributable to a Private Fund is the regulatory assets under management (as defined under Form ADV). The Private Fund RIA must aggregate assets across any parallel managed accounts (unless the value of those accounts exceeds the value of the Private Funds with which

they are managed) and Private Funds managed by the Private Fund RIA's related persons (unless the related persons are separately operated).

FORM PF: FILING REQUIREMENTS

The frequency of filing and the time period given for compiling the information varies based on the size and type of Private Fund RIA. We have prepared a guide to the filing requirements for different types of Private Fund RIAs, which is attached as Annex A.

Generally, Large Hedge Fund Advisers are required to file quarterly within 60 days of quarter end and Large Liquidity Fund Advisers are required to file quarterly within 15 days of quarter end. All other Private Fund RIAs, including Large Private Equity Fund Advisers, are required to file annually within 120 days of the fiscal year-end.

FORM PF: CONTENT

Form PF is daunting in length. It has five separate sections. Different kinds and sizes of Private Fund RIAs are required to fill out different sections.

The information provided on Form PF will be kept confidential among the SEC, the CFTC and FSOC and may not be disclosed, except to Congress upon agreement of confidentiality, to comply with a request by any other U.S. federal government department or agency or any self-regulatory organization within its scope of jurisdiction, or by order of a U.S. court in an action brought by the United States or the SEC. Notably, the SEC also makes clear that the information can be used in enforcement proceedings. However, in a concession to commenters, the SEC removed a requirement that the individual signing the form affirm "under penalty of perjury" that the statements made in the Form are true and correct (although a willful misstatement could still constitute a violation of the Advisers Act).

The SEC also modified the form to emphasize the ability of Private Fund RIAs to rely on their existing internal methodologies. In particular, the SEC modified the performance reporting requirement to allow a Private Fund RIA to report on the same basis as provided to investors or as otherwise calculated internally. Thus, it does not require, as proposed, that Private Fund RIAs provide monthly performance with respect to all of their Private Funds.

We have prepared a guide to the reporting requirements for different types of Private Fund RIAs, attached as Annex B. Noteworthy among the requirements are the following:

- Section 1 requires fund performance data on the same basis as reported to investors (*i.e.*, monthly, quarterly or annually).

- Form PF requires advisers to Hedge Funds to provide information concerning investment strategies, counterparty exposures and trading and clearing practices. It also requires extensive disclosure from Large Hedge Fund Advisers, in particular with respect to Qualifying Hedge Funds (those that have a net asset value of at least \$500 million). These advisers are required to provide more detail concerning liquidity, concentration, collateral practices, risk metrics and financing relating to these Qualifying Hedge Funds.
- Large Private Equity Fund Advisers are required to provide information on the indebtedness of certain portfolio companies and investments by the fund (by industry and geography).

APPLICATION TO NON-U.S. ADVISERS

The filing requirements for Form PF apply to any Private Fund RIA, even one that has its principal office and place of business outside of the United States. However, such an adviser does not need to report any information with respect to a Private Fund that is neither (i) a U.S. person nor (ii) offered to or beneficially owned by a U.S. person. The term “U.S. person” has the same definition as in the Rule 203(m)-1 under the Advisers Act and is similar but not identical to the definition in Regulation S under the Securities Act of 1933.⁴

INITIAL FILINGS; FILING FEES

As set forth in Annex B, the effective date depends on the type of Private Funds advised by the Private Fund RIA and the AUM associated with those Private Funds. For example, as a general matter, a Large Hedge Fund Adviser that has more than \$5 billion in AUM related to Hedge Funds is required to file its initial Form PF 60 days following the end of its first fiscal quarter following June 15, 2012. The typical Private Equity Fund Adviser will be required to make its initial Form PF filing by April 30, 2013.

There is a \$150 filing fee associated with Form PF in order to finance the development and maintenance of a new filing system for the Form. Thus, Private Fund RIAs will bear not only the costs of preparing the form, but filing it as well.

⁴ *Rules Implementing Amendments to the Investment Advisers Act of 1940, SEC Release No. IA-3221 (Jun. 22, 2011). See also our Client Update: SEC Adopts Final Dodd-Frank Advisers Act Requirements but Delays Implementation Until 2012 (June 27, 2011), available at <http://www.debevoise.com/news/press/publications/detail.aspx?id=b1e11ea8-fd9a-45da-a6cb-c4f70530d76c>*

CFTC

In addition to adopting Sections 1 and 2 of Form PF, the CFTC has adopted final Rule 4.27. Under Rule 4.27, CFTC-registered CPOs or CTAs that are also SEC-registered investment advisers and are required to file Form PF may file Form PF with the SEC as a substitute for certain of the CFTC's proposed systemic risk reporting requirements. In addition, such dually registered CPOs or CTAs may submit on Form PF data regarding commodity pools that are not private funds as a substitute for compliance with such CFTC reporting requirements. The CFTC has proposed, but has not yet adopted, Form CPO-PQR and CTA-PR, which CPOs and CTAs would have to file to satisfy such reporting obligations.

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ANNEX A: SUMMARY OF FILING REQUIREMENTS

Type of Private Fund RIA	Required Sections	Initial Filing Date	Frequency of Filing	Filing Date	Initial Filing Date (for FY End 12/31)
Large Hedge Fund Advisers (>\$1.5 billion)	1a, 1b, 1c, 2a, 2b	First fiscal quarter following June 15, 2012 (if >\$5 billion) First fiscal quarter following Dec. 15, 2012 (if <\$5 billion)	Quarterly	60 days following end of fiscal quarter*	Aug. 29, 2012 (if >\$5 billion) Mar. 1, 2013 (if <\$5 billion)
Large Liquidity Fund Advisers (>\$1 billion)	1a, 1b, 3	First fiscal quarter following June 15, 2012 (if >\$5 billion) First fiscal quarter following Dec. 15, 2012 (if <\$5 billion)	Quarterly	15 days following end of fiscal quarter*	Jul. 15, 2012 (if >\$5 billion) Jan. 15, 2013 (if <\$5 billion)
Large Private Equity Fund Advisers (>\$2 billion)	1a, 1b, 4	First fiscal year following June 15, 2012 (if >\$5 billion) First fiscal year following Dec. 15, 2012 (if <\$5 billion)	Annually	120 days following end of fiscal year	Apr. 30, 2013
All Hedge Fund Advisers	1a, 1b, 1c	First fiscal year following Dec. 15, 2012	Annually	120 days following end of fiscal year	Apr. 30, 2013
All Other Private Fund RIAs	1a, 1b	First fiscal year following Dec. 15, 2012	Annually	120 days following end of fiscal year	Apr. 30, 2013

* Both large hedge fund advisers and large liquidity fund advisers will be permitted to amend the annual filing within 120 days of the year end.

ANNEX B: SUMMARY OF FORM PF REPORTING REQUIREMENTS FOR HEDGE FUND AND PRIVATE EQUITY FUND MANAGERS⁵

All Private Fund Advisers (Sections 1a & 1b)

- The assets under management relating to each category of Private Funds (hedge, liquidity, private equity, real estate, securitized asset, venture capital and other) and to non-Private Fund clients;
- the gross and net asset value of each Private Fund;
- the amount of borrowings of each Private Fund (and source by category);
- summary of the assets and liabilities of each Private Fund by valuation categories (based on GAAP fair value hierarchy, which categorizes assets and liabilities based on the availability of market prices from quoted prices in active markets to values based on unobservable inputs);
- investor concentration information (*i.e.*, beneficial ownership percentages by categories of investors including U.S. individuals, non-U.S. individuals, broker-dealers, insurance companies, etc.); and
- fund performance data on the same basis as reported to investors (*i.e.*, monthly, quarterly or annual).

All Hedge Fund Advisers (Section 1c)

- Good faith estimates of the percentage of the Private Fund's assets that are allocated to different categories of investment strategies;
- percentage of the fund's net asset value managed using high-frequency trading strategies,⁶

⁵ *A summary of the enhanced reporting requirements for liquidity funds has not been included.*

⁶ *While the term "high-frequency trading strategies" is not defined, the form states that this question is concerned with strategies that are substantially computer-driven where investment and trading decisions are primarily based on algorithmic responses to intraday price action in equities, futures and options and where the total number of shares or contracts traded throughout the day is generally significantly larger than the net change in position from one day to the next. It does not concern strategies using algorithms solely for trade execution.*

- significant trading counterparty exposures (including the identity of the five trading counterparties to which the fund has the greatest net counterparty credit exposure and that have the greatest net counterparty credit exposure to the fund); and
- trading and clearing practices (regulated exchanges versus over-the-counter, central clearing counterparty versus bilateral).

All Large Hedge Fund Advisers (Sections 2a & 2b)

- The market value of assets invested (on a short and long basis) in different types of securities and commodities (*e.g.*, equity, equity derivatives, corporate bonds, convertible bonds, sovereign bonds, loans, repos, ABS/structured products, credit derivatives, foreign exchange derivatives, interest rate derivatives, commodities, real estate, private funds, registered funds and cash);
- the duration of fixed income portfolio holdings (to indicate the assets' interest rate sensitivity);
- the turnover rate of the RIA's aggregate portfolios during the reporting period (to provide an indication of the RIA's frequency of trading); and
- a geographic breakdown of investments held by the Hedge Funds.
- with respect to Qualifying Hedge Funds (greater than \$500 million),
 - the market value of assets invested (on a short and long basis) in different types of securities and commodities;
 - the duration of fixed income portfolio holdings (to indicate the assets' interest rate sensitivity);
 - portfolio liquidity (including the percentage of the fund's portfolio capable of being liquidated within different time periods);
 - concentration of positions (including positions that represent 5% or more of the fund's net asset value);
 - collateral practices with significant counterparties (including value of collateral for the top five counterparties to which the fund has exposure and top five counterparties which have exposure to the fund);

- detailed information on Value-at-Risk calculations, identification of other risk metrics and sensitivities of the Private Fund's portfolio to specified changes of certain identified market factors, such as risk-free interest rates, credit spreads, currency rates, etc.;
- certain financing information (including a monthly breakdown of the value of its unsecured and secured (including reverse repo and other unsecured) borrowing and its derivatives positions, the value of the collateral supporting derivative positions that were not cleared by a central clearing counterparty, available financing liquidity by time category (from less than one day through more than one year), and the identity and amount of each creditor with borrowing of at least 5% of the Private Fund's net asset value); and
- investor composition and liquidity (including questions about the fund's side pocket arrangements, restrictions on investor withdrawals and redemptions and investor liquidity by time category (from less than one day through more than one year)).

Large Private Equity Fund Advisers (Section 4)

- Indebtedness of controlled portfolio companies⁷ (including the weighted average, high and low of their debt-to-equity ratios, the aggregate gross asset value, and the aggregate principal amount of borrowing categorized as current and long-term (and also, separately, payment-in-kind or zero-coupon debt));
- events of default by the Private Fund or any controlled portfolio company under any loan agreements;
- bridge loans (a term which is not defined by the Form) by any person to controlled portfolio companies (including the identity and amount of any creditor or counterparty);
- investments by the fund in portfolio companies that are in the financial industry; and
- breakdowns of the fund's investments by industry and geography.

⁷ For these purposes, "controlled portfolio company" means a portfolio company "controlled" by the fund (alone or together with affiliates of the fund or as part of a club or consortium). "Control" for these purposes has the same meaning as under Form ADV.