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Consequences of the Dodd-Frank Act: New Private Fund Reporting Requirements

Skadden

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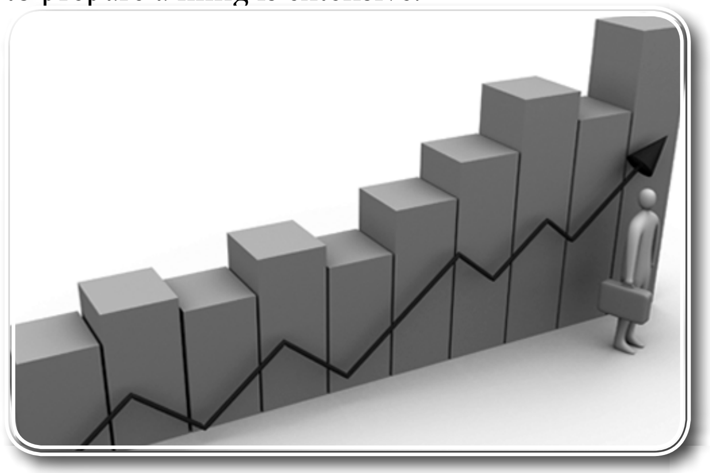
The Dodd-Frank Act greatly increased the reporting requirements applicable to private investment funds and their advisers. In recent months, both the SEC's and CFTC's new reporting forms have become effective. Now that the initial round of filings is complete for the largest advisers, we expect that their experiences will prove instructive for advisers preparing their first reporting forms.

Form PF

Registered investment advisers that advise at least one private fund[1] and have at least $150 million in private fund regulatory assets under management are required to file Form PF, the SEC's new systemic risk reporting form. Form PF requires advisers to report detailed information with respect to their private funds, including the use of leverage and derivatives, collateral practices, counterparty exposures, liquidity, and investment strategies. Large private fund advisers[2] are required to provide the SEC with additional detailed information regarding their hedge funds, liquidity funds, and private equity funds, respectively.

The first wave of Form PF filings for hedge fund advisers occurred in August 2012 and consisted of the largest advisers (advisers with at least $5 billion in regulatory assets under management attributable to hedge funds). The filing deadline for smaller advisers will occur in the first months of 2013.

The experiences of the August filers provide useful insights for advisers who have yet to file their first Form PF. First and foremost, the initial filers have shown that getting an early start on Form PF is essential. Not only does Form PF ask for large amounts of information, but the process of completing Form PF is unlike any that advisers have been asked to fulfill in the past. The questions on Form PF require active input across an adviser's business lines, from legal and compliance departments to portfolio managers, operations, and technology personnel. Many of the early filers learned that Form PF is as much a financial reporting form as it is a legal reporting form, making collaboration across business lines imperative. Some of the questions on Form PF require qualitative judgments, which not only add time but makes automation of the responses difficult, if not impossible. Due to the volume of information and the various departments that must collaborate to complete Form PF, the time required to prepare a filing is extensive.



Many of the questions on Form PF are ambiguous and subject to interpretation. Filers have the opportunity to indicate any assumptions they have made while completing Form PF in Question 4: Miscellaneous, and it is expected that the responses provided in the Miscellaneous section will help the SEC refine the guidance offered in their Frequently Asked Questions on Form PF. The early filers have shown a variety of approaches to the Miscellaneous section. Some advisers chose to use the Miscellaneous section as a way to document all of the judgment calls the adviser made in preparing Form PF, and as a result filed many pages of assumptions. Other advisers took a restrained approach by listing only select high-level assumptions that applied to all of their funds generally, and a few advisers listed minimal or no assumptions at all. Regardless of an adviser's approach to the Miscellaneous section, the touchstone of reporting on Form PF is to ensure that the adviser's responses are consistent with the information provided by the adviser on other SEC reporting forms, such as Form ADV, and with the adviser's internal books and records.

Finally, advisers have grappled with deciding whether to prepare Form PF in-house or to hire outside service providers. Some of the initial filers prepared Form PF entirely in-house; however, the early filers represent the largest asset managers, typically with sizeable internal legal, compliance, and operations staff. Other managers may find Form PF's complexity to be a drain on internal resources and prefer to use an outside service provider. A number of large administrators and accounting firms offer Form PF preparation and filing services, and many advisers have found efficiencies in utilising existing service providers to assist with the process. However, the adviser's various internal departments must be involved to respond to the qualitative questions on Form PF and to ensure consistency with the adviser's other filings and books and records.

CFTC Forms CPO-PQR, CTA-PR & NFA Pool Quarterly Reports

With the Dodd-Frank Act's expansion of the CFTC's jurisdiction to include swaps, many private fund advisers have recently registered as CPOs and/or CTAs. Registering as a CPO or CTA brings an adviser within the scope of the CFTC's new systemic risk reporting requirements. Under these requirements, registered CPOs report quarterly or annually (with the period being determined by the amount of "commodity pool" assets under management) on Form CPO-PQR and registered CTAs report annually on Form CTA-PR.[3] Registered CPOs and CTAs are also required to become members of the NFA, a self-regulatory organisation, which imposes its own reporting requirements in addition to the CFTC's. Registered CPOs must file the NFA's Form PQR quarterly and registered CTAs may soon be required to file the NFA's proposed Form PR, also quarterly.[4]

Fortunately, private fund advisers that file Form PF and are registered as CPOs may avoid the more burdensome schedules of Form CPO-PQR; the CFTC allows these advisers to complete the corresponding sections of Form PF instead.

It appears that advisers who have a choice of consolidating some of their systemic risk reporting into their Form PF filing are choosing to do so.

Like Form PF, Forms CPO-PQR and CTA-PR contain questions that require some additional interpretation. One of the more common issues in completing Forms CPO-PQR or CTA-PR is appreciating the scope of the "commodity pool" definition, which the CFTC and its staff have interpreted broadly to mean any "investment trust, syndicate or similar form of enterprise" that uses even a single CFTC-regulated product.

For example, the staff of the CFTC's Division of Swap Dealer and Intermediary Oversight has recently issued letters that include as commodity pools certain types of mortgage REITs, structured finance vehicles and family investment vehicles, while other letters have made clear that equity REITs, most securitisations and other family investment vehicles would not be viewed to be commodity pools.

As a result of the complexity of this definition, private fund investment advisers that are subject to the CFTC's and NFA's systemic risk reporting requirements may underestimate the complexity of particular questions that are dependent on the commodity pool definition (for example, Question 2.b. of Form CTA-PR, which asks about the "total pool assets" directed by the CTA).

Another consequence of the CFTC's broad interpretation of the commodity pool definition is that a private fund adviser that is dually registered as a CPO may be subject to systemic risk reporting requirements for a wider variety of pooled investment vehicles than just private funds. For example, if a private fund adviser is also the CPO to a mutual fund, it would be required by the CFTC to file a systemic risk report (either on Form PF or Form CPO-PQR) with respect to that mutual fund.

While select CPOs began filing Form CPO-PQR in November of 2012, many other CPOs and CTAs only became registered on January 1, 2013. Accordingly, many in the investment management community have yet to work through the CFTC's and NFA's reporting requirements.

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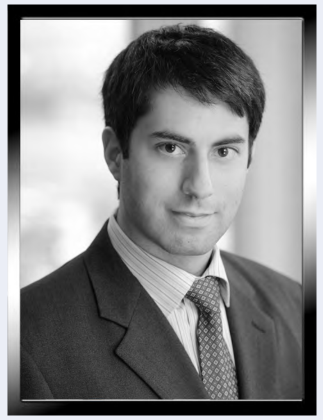

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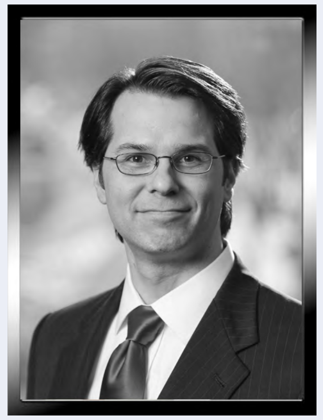

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1 - A "private fund" is defined as any issuer that would be an investment company as defined in Section 3 of the Investment Company Act of 1940 but for Section 3(c)(1) or 3(c)(7) of that Act.

2 - Large private fund advisers are defined in Form PF to include (i) advisers with at least $1.5 billion in hedge fund assets under management ("Large Hedge Fund Advisers"), (ii) advisers with at least $1 billion in liquidity fund assets under management ("Large Liquidity Fund Advisers"), and (iii) advisers with at least $2 billion in private equity fund assets under management ("Large Private Equity Fund Advisers").

3 - A commodity pool is defined as "an investment trust, syndicate or similar form of enterprise operated for the purpose of trading" any CFTC-regulated products.

4 - In addition to proposing Form PR, the NFA also has proposed to amend the current Form PQR to incorporate many of the questions from Schedule A of CFTC Form CPO-PQR.