

Articles + Publications | January 26, 2022

SEC Proposed Form PF Amendments Kick Off SEC Chair Gensler's Push for Increased Transparency for Private Funds

WRITTEN BY

Stephanie Pindyck Costantino | Jay A. Dubow | Genna Garver | Ghillaine A. Reid | Zachary R. Epstein

This article was republished in the May 2022 issue of The Investment Lawyer.

On January 26, the SEC approved [proposed amendments to Investment Advisers Act Rule 204\(b\)-1](#) and Form PF to require prompt reporting of certain extraordinary events that may signal distress or market instability. The proposals are material and could significantly impact private fund advisers, including smaller advisers falling below the current threshold for large reporters. In a shift from prior SEC practice of 60 days, the comment period for the proposal is only 30 days from the date of publication in the *Federal Register* (which has yet to occur as of the date of this advisory).

Notably, the proposal would reduce the reporting threshold for large private equity fund advisers from \$2 billion to \$1.5 billion in assets under management.[\[1\]](#) Chair Gary Gensler hopes this change will recalibrate the scope of reporting by fund managers back to the proportion of the industry covered (based on committed capital) when Form PF was initially adopted, which represents about 75% of the assets under management.[\[2\]](#)

Specifically, the proposal would require large hedge fund advisers to report within one business day:

- certain extraordinary investment losses (loss equal to or greater than 20% of a fund's most recent net asset value over a rolling 10 business day period);
- significant margin and counterparty default events (e.g., a cumulative increase in margin of more than 20% of the reporting fund's most recent net asset value over a rolling 10 business day period);[\[3\]](#)
- material changes in prime broker relationships (e.g., material changes to the fund's ability to trade or an outright termination of the prime brokerage relationship for default or breach of the prime brokerage agreement);
- changes in unencumbered cash (e.g., the value of the reporting fund's unencumbered cash declines by more than 20% of the reporting fund's most recent net asset value over a rolling 10 business day period);[\[4\]](#)
- significant disruption or degradation of the reporting fund's key operations[\[5\]](#) (e.g., a 20% disruption or degradation of normal volume or capacity); and
- events associated with withdrawals and redemptions (exceeding 50% of the most recent net asset value).

All private equity fund advisers would be required to report within one business day events pertaining to:

- the execution of adviser-led secondary transactions;[\[6\]](#)
- implementation of general partner or limited partner clawbacks;[\[7\]](#)
- investors' removal of a fund's general partner; and
- investors' election to terminate a fund's investment period, or investors' election to terminate a fund.

Large private equity fund advisers would also be required to provide information regarding fund strategies':

- use of leverage and portfolio company;
- financings;
- controlled portfolio companies and borrowings;
- fund investments in different levels of a single portfolio company's capital structure; and
- portfolio company restructurings or recapitalizations.

Large liquidity fund advisers would be required to report substantially the same information that money market funds would report on Form N-MFP, as the SEC proposes to amend it.

Not all of the commissioners are on board with the proposals. Commissioner Peirce voiced fundamental objections, including the shift in Form PF's scope and purpose, which was primarily intended to assist the Financial Systemic Oversight Commission (FSOC) in its monitoring obligations under the Dodd-Frank Act. She stated, "Congress didn't conceive Form PF to inoculate well-heeled investors against fund failures." While acknowledging certain information gaps in the current Form PF, she questioned whether the SEC's desire to fill these gaps was "born of necessity or curiosity," and argued the proposing release provides scant evidence that the amendments would enhance the ability to monitor systemic risk. There is, of course, support for increased concerns of systemic risk, mainly stemming from the market stress of the global pandemic. Last year, at the request of U.S. Treasury Secretary and FSOC Chairperson Janet L. Yellen, the FSOC reconvened its Hedge Fund Working Group, which had last reported to FSOC in 2016. Commissioner Peirce expressed concern that the real-time reporting requirements were essentially inadequately justified micromanagement. As for the reduction in the reporting threshold, Commissioner Peirce believes the threshold should be increased rather than reduced because market growth has increased the number of funds above the threshold. Indeed, requiring smaller fund advisers to report in real time, while they are in the midst of the extraordinary event, could be potentially harmful.

The proposed Form PF amendments come amid a larger push by Chair Gensler to heighten regulation of private

equity and hedge funds, as Gensler continues his focus on increasing transparency and market efficiency in those sectors. In a virtual speech to the Washington, DC Exchequer Club last month, Gensler said that he intends to use the agency's "authorities to bring greater transparency and competition into that market," which "helps portfolio companies on the one hand, and the pensions and endowments that are investing in that space on the other."^[8]

Gensler indicated a desire to overhaul disclosure requirements in private funds as early as May 2021. While addressing the U.S. House Appropriations Committee's Subcommittee on Financial Services and General Government, Gensler pointed to the industry's rapid growth as a justification for increased scrutiny. In his testimony, Gensler noted the "[eight] percent increase over the last five years" in private equity and capital funds.^[9] Gensler argued that because "[t]here is no self-regulatory organization for investment advisers like there is for broker-dealers," the SEC must "grow and evolve with the industry."^[10] Gensler again cited the industry's size in his speech last month, estimating that private equity and hedge funds hold approximately \$17 trillion in assets under management, and charge about \$250 billion in fees and expenses each year.^[11]

Institutional investors also are pushing for enhanced disclosure requirements by private fund advisors. In December 2021, leaders of various public sector unions — including the National Education Association (NEA); American Federation of State, County, and Municipal Employees (AFSCME); and Service Employees International Union (SEIU) — wrote an open letter to Gensler, emphasizing the need for "proper oversight."^[12] Adopting similar recommendations from another group of unions and advocates for financial reform,^[13] union leaders specifically urged the SEC to "consider updates to Form PF requirements to capture more comprehensive information about the holdings, sources of credit and other practices of private fund advisers," among other proposed reforms.^[14]

Public sector unions are not the only organizations voicing concern about a lack of transparency by private fund advisors. The Institutional Limited Partners Association (ILPA) wrote to Gensler in May 2021, applauding him for his "statement at [his] confirmation hearing that the disclosure of fees and conflicts of interests by private equity advisers sits 'at the heart of the Investment Advisers Act.'"^[15] ILPA, who says its "550+ member institutions represent over USD 2 trillion in private equity assets under management globally," wrote that "under current SEC regulations, limited partners routinely fail to receive adequate transparency in these areas."^[16]

Further, Gensler has voiced concern that investors may not fully understand the fees they are charged. He said that investors are billed for "consulting fees, advisory fees, monitoring fees, servicing fees, transaction fees, [and] director's fees," and many believe they are assessed unnecessary costs.^[17] As a result, Gensler said that more transparency in this area "could help lower the cost of capital for businesses raising money," "raise the returns for the pensions and endowments behind the limited partner investors," and "help workers preparing for retirement and families paying for their college educations."^[18]

It will be important for private equity and hedge fund advisers to keep track of these proposals as they near approval.

If you have any questions regarding the proposed amendments to Form PF, the regulation of private equity and hedge fund fees, SEC enforcement actions, your company's policies and procedures, or questions otherwise relating to the above alert, please contact any of the Troutman Pepper attorneys listed on this advisory.

[1] In addition to large private equity fund advisers, the current version of Form PF defines large hedge fund advisers (\$1.5 billion in hedge fund assets under management), and large liquidity fund advisers (\$1 billion in combined money market and liquidity fund assets under management).

[2] The current threshold only captures about 67% of the U.S. private equity industry. According to the proposing release, there were 6,910 funds with \$1.60 trillion in gross assets in first quarter of 2013 and 15,584 funds with \$4.71 trillion in gross assets in the fourth quarter of 2020. See pages 8 and 54 of the proposing release.

[3] Reporting would include the legal name and LEI (if any) of the counterparty. The proposal sets the threshold for reporting counterparty defaults at 5% of the most recent net asset value to limit the reports for de minimis or superficial defaults that may be the result of a short-lived operational error. See page 25 of the proposing release.

[4] The proposal would require an addition filing if the decrease in unencumbered cash were to continue past the initial 10-day period.

[5] Key operations would include the investment, trading, valuation, reporting, and risk management of the reporting fund, as well as the operation of the reporting fund in accordance with the federal securities laws and regulations. This includes a cybersecurity event that disrupts the trading volume of a reporting fund by 20% of its normal capacity, an inability to value the fund's assets because of an operational issue with a service provider, and certain severe weather events causing power outages. Reporting would require disclosure of whether the adviser has initiated a business continuity plan in response to the event.

[6] The proposal would define an “adviser-led secondary transaction” as any transaction initiated by the adviser or any of 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.

[7] While reporting would be required upon the implementation of any general partner clawback, the proposal would require reporting when an adviser implements a limited partner clawback (or clawbacks) in excess of an aggregate amount equal to 10% of a fund's aggregate capital commitments.

[8] See Gary Gensler, Chairman, Sec. and Exch. Comm'n, Dynamic Regulation for a Dynamic Society (Jan. 19, 2022), <https://www.sec.gov/news/speech/gensler-dynamic-regulation-20220119>.

[9] See Gary Gensler, Chairman, Sec. and Exch. Comm'n, Testimony Before the Subcommittee on Financial Services and General Government, U.S. House Appropriations Committee (May 26, 2021), <https://www.sec.gov/news/testimony/gensler-2021-05-26>.

[10] See *id.*

[11] See Gensler, Dynamic Regulation for a Dynamic Society, *supra*.

[12] See Letter from Public Sector Unions to Gary Gensler, Chairman, Sec. and Exch. Comm'n (Dec. 7, 2021), <https://www.nea.org/advocating-for-change/new-from-nea/union-letter-sec-private-equity-oversight>.

[13] See Letter from Americans for Financial Reform to Gary Gensler, Chairman, Sec. and Exch. Comm'n (July 14, 2021),
<https://ourfinancialsecurity.org/2021/07/letters-to-the-regulators-a-ref-letter-to-the-sec-on-addressing-private-equity-abuses/>.

[14] See Letter from Public Sector Unions, *supra*.

[15] See Letter from Steve Nelson, CEO, Institutional Ltd. Partners Ass'n (LIPA) to Gary Gensler, Chairman, Sec. and Exch. Comm'n (April 21, 2021),
<https://ilpa.org/wp-content/uploads/2021/04/2021.4.20-ILPA-Welcome-Letter-to-Chairman-Gensler-Final.pdf>.

[16] See *id*.

[17] See Gary Gensler, Chairman, Sec. and Exch. Comm'n, Prepared Remarks at the Institutional Ltd. Partners Ass'n Summit (Nov. 10, 2021), <https://www.sec.gov/news/speech/gensler-ilpa-20211110>.

[18] See *id*.

RELATED INDUSTRIES + PRACTICES

- Investment Funds + Investment Management Services
- Private Equity
- Securities Investigations + Enforcement
- White Collar Litigation + Investigations