

REGISTRATION AND FORM PF PREPARATION

This information bulletin will address the following topics of discussion:

- I. Overview of the Dodd-Frank Wall Street Reform and Consumer Act (Dodd-Frank)
- II. Overview of Form PF filing requirements
- III. Form PF Practical Considerations & Comments

I. OVERVIEW OF DODD-FRANK ACT:

Signed into law on July 21, 2010, the Dodd-Frank Act includes the Private Fund Investment Advisers Registration Act of 2010, which will require certain previously unregistered private investment fund advisers to register with the SEC and impose additional reporting requirements (Form PF). The Act also established the Financial Stability Oversight Council (FSOC), which is comprised of the leaders of various financial regulators. Its purpose is to monitor emerging risks to U.S. financial stability and to require that the Board of Governors of the Federal Reserve System supervise designated non-bank financial companies that may pose risks to U.S. financial stability.

Dodd-Frank eliminates the private adviser registration exemption found in section 203(b)(3) of the Investment Adviser Act of 1940 and once private fund advisers are required to register with the SEC, they will be subject to all of the provisions of the Adviser Act including rules relating to client asset custody, recordkeeping, advisory contracts, performance fees and investment and financial reporting.

Who Needs to Register?

An investment adviser is required to register either with the SEC or the States but not necessarily both.

- Private Fund Investment Advisers with more than \$150 million AUM are required to file with the SEC.
- An adviser with AUM between \$25 million and \$100 million (mid-sized adviser) is required to register with the States. If an adviser is registered with 15 or more States it may elect to register with the SEC.
- Advisers with AUM in excess of \$25 million and who have their principal office and place of business in New York, Minnesota or Wyoming are required to register with the SEC.
- Most mid-sized advisers currently registered with the SEC will be required to withdraw their registration and register with one or more state securities authorities.
- Advisers are required to assess their eligibility for registration on an annual basis. If an adviser is no longer eligible for SEC registration at the end of its fiscal year, the Final Rules provide a 180-day grace period from the adviser's fiscal year end to allow it to switch to state registration.

Assets under management definition takes into consideration assets under control, meaning an Investment Adviser will need to factor in leverage before they make the determination of which category they fall into.

Important Dates

- **January 1, 2012:** Mid-sized SEC registered investment advisers that must transition to state registration must remain SEC-registered until this date.
- **February 14, 2012:** All advisers relying on the "private adviser" exemption that are required to register should file Form ADV by this date.
- **March 30, 2012:** All advisers newly required to register must be registered by this date. Current SEC-registered investment advisers must file an amendment to Form ADV.
- **June 28, 2012:** Mid-sized advisers no longer eligible for registration must withdraw their SEC registrations by this date.

II. OVERVIEW OF PROPOSED FORM PF:

The Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC) have proposed new rules under the Commodities Exchange Act and the Investment Adviser Act of 1940 to implement provisions of Title IV of the Dodd-Frank Act.

The proposed SEC rule would require investment advisers registered with the SEC that advise one or more private funds to file Form PF with the SEC. The proposed CFTC rule would also require commodity pool operators (CPOs) and commodity trading advisers (CTAs) registered with the CFTC satisfy certain proposed CFTC filing requirements by filing Form PF with the SEC, but only if those CPOs and CTAs are also registered with the SEC as investment advisers and advise one or more private funds.

Purpose

In response to the near collapse of the financial system in 2008, many legislative measures have been implemented in order to attempt to reduce systemic risk and prevent a collapse in the future. Form PF has been designed to identify, define, monitor, measure and track risks associated with alternative and private fund strategies. The amount of detail necessary and frequency of reporting will be determined by the size of each fund as well as in aggregate across all investment adviser assets.

Who Needs to File?

The proposed filing requirement would require SEC registered investment advisers to electronically file Form PF with the SEC.

- SEC Registered Advisers (all types) that manage one or more private funds will be required to report on a quarterly or annual basis.
- Jointly Registered SEC and CFTC Advisers that manage one or more private funds.
- Managers that provide advice to a private fund, in most cases a 3(c)(1) or 3(c)(7).

Reporting Requirements

Form PF proposes to require a registered adviser to maintain the following information (depending on size) and report for each private fund it advises. Highlights include:

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| ➤ Cash & Collateral Management | ➤ Investor Concentrations | ➤ Trading & Investment Position Breakdown by Asset Class |
| ➤ Concentration Position Analysis | ➤ Leverage Usage including Financial Institutions | ➤ Unencumbered Cash |
| ➤ Counterparty Credit Risk Analysis | ➤ Liquidity Attribution | ➤ Valuation Policies and Practices |
| ➤ Derivative Positions & Collateral | ➤ Risk Metrics, including VAR Calculation & Reporting | |
| ➤ Financing Liquidity | ➤ Strategy | |
| ➤ Gross & Net Asset Value Variations (monthly, quarterly) | ➤ Trading & Clearing Practices | |
| ➤ Gross & Net Performance (monthly, quarterly) | | |

Private fund advisers have been divided into two categories – large advisors and small advisers. The amount of information and reporting will depend on the group to which the adviser belongs and the types of funds the adviser manages.

- **Small Advisers:** AUM of less than \$1 billion. File Form PF only once a year (Section 1 only) within 90 days of the end of their fiscal year (same as Form ADV filing).
- **Large Advisers:** AUM of greater than \$1 billion. File Form PF within 15 days of the end of each calendar quarter.

Newly registered private fund advisers would be required to file their initial Form PF within 15 days of the end of the next occurring calendar quarter after registering with the SEC. For small advisers this would imply, at minimum, two filings for 2012 (initial and annual filings).

The filing has Sarbanes-Oxley like implications as the Form must be certified under penalty of perjury under the laws of the United States. The authorized signatory must be:

- For a partnership, a general partner
- For a limited liability company, a managing member or authorized person

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III. FORM PF PRACTICAL CONSIDERATIONS & COMMENTS

Though the final version of Form PF is not yet determined, nor the effective date finalized, it is clear this will be another regulatory requirement that private investment managers will need to address. The filing possesses a new set of transparency and disclosure requirements which will challenge the current operating environment of most managers. Its scope of information requested is unprecedented and the ramifications for misfiling are severe (the owner of the company certifies the filing “under penalty of perjury”). Although its original intent was for the FSOC to garner information to understand and “mitigate” systemic risk, in reality the purpose will take years to fully comprehend.

While most managers view this as a “compliance responsibility,” it is more than just compliance; it is an enterprise-wide requirement that is centered on risk, performance, counterparty credit and treasury management functionality. To date, no one service provider solution exists that will capture all the data elements required; therefore it will be incumbent on the investment manager to fill the gaps and quarterback the effort. HC sees these trends developing as an outgrowth of this requirement:

- SEC field examinations will be fueled by the information provided in Form PF.
- Astute investors will eventually request Form PF as part of their due diligence process.
- More managers will be affected than originally thought as leverage gearing will drive registration and Form PF disclosures.
- Forward-thinking managers will develop an enterprise-wide approach to compiling and reconciling the data on a daily basis. The affect will be to differentiate itself from its peers.

Based on our analysis to date, our recommendations for managing this process are as follows:

- Managers need to drive data requirements and develop customized solutions.
- Develop a mock Form PF process; smaller funds should perform at least once per month (if leverage is employed more frequently), larger funds should perform daily.
- Create exception processing surrounding delta movements and a reconciliation/verification process before actual filing to ensure accuracy.
- Develop a roadmap for all the data elements, including the sources of data (internal/external).
- Normalize and reconcile all data sources, including marketing materials, ADV filings and investor communications.
- Identify Risk management technologies to support the various risk calculations required.
- Utilize third parties where appropriate to extract core information and provide data in a useful and flexible fashion.

HC Associates is working with our partners in the industry to monitor this filing requirement, and we plan to provide additional information as it becomes available. For more information or assistance please contact us at any time.

For more information on the topics discussed in this bulletin or HC's services, please contact:

WEST COAST

Edward R. Tedeschi
 o: (925) 648-8037
 m: (925) 683-7623
 etedeschi@hcassociates.net

EAST COAST

Carl J. Versella
 o: (732) 566-6761
 m: (917) 232-0750
 cversella@hcassociates.net

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