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March 21, 2022

Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Amendments to Form PF to Require Current Reporting and Amend Reporting Requirements for Large Private Equity Advisers and Large Liquidity Fund Advisers (File No. S7-01-22)

Dear Ms. Countryman:

We are responding to the request of the Securities and Exchange Commission (the "Commission") for comments about the proposed amendments to Form PF (the "Proposed Amendments").[1] We recognize the time and effort invested by the Commission and the Staff of the Division of Investment Management in formulating the Proposed Amendments and appreciate the opportunity to comment.

Schulte Roth & Zabel LLP is an international law firm, with offices in New York, London and Washington, D.C. Our clients include many advisers to private funds that may be affected by the Proposed Amendments as well as institutional investors and limited partners. We regularly advise private fund manager clients with respect to their regulatory reporting obligations including with respect to Form PF. These comments, while informed by our experience in representing these clients, represent our own views and are not intended to reflect the views of the clients of the firm.

I. Introduction

On January 26, 2022, the Commission issued the Proposed Amendments to enhance the Financial Stability Oversight Council's (the "FSOC") ability to monitor private fund systemic risk as well as to enhance the Commission's investor protection efforts with respect to private fund advisers. The Proposed Amendments would amend Form PF to expand the type and amount of information the Commission collects from certain private fund advisers as well as to increase

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[1] *Amendments to Form PF to Require Current Reporting and Amend Reporting Requirements for Large Private Equity Advisers and Large Liquidity Fund Advisers*, Release No. IA-5950; File No. S7-01-22 (the "Proposing Release").

the overall percentage of combined regulatory assets under management ("RAUM") it captures from the U.S. private equity industry.

We appreciate the Commission's efforts to bolster investor protection and enhance the FSOC's ability to assess systemic risk. The Proposed Amendments would be a significant shift in the timing and substance of the information reported on Form PF, and we have the following comments and suggestions. In summary, we respectfully request that the Commission:

(i) Consider changing the time to file after a reporting event is triggered from one business day to a "prompt" update as that term has been utilized in the context of other SEC filings by investment advisers;

(ii) Consider changing certain thresholds with respect to the circumstances that would trigger reporting events for large hedge fund advisers or removing certain events altogether;

(iii) Consider removing the new reporting requirements for private equity advisers or, in the alternative, only require such reporting as part of the annual Form PF filing by private equity fund advisers; and

(iv) Consider maintaining the threshold for large private equity advisers at $2 billion.

II. Reporting on a One Business Day Basis

Under the Proposed Amendments, large hedge fund advisers to qualifying hedge funds and all advisers to private equity funds would be required to file reports within one business day of the occurrence of certain key events ("reporting events").[2] Requiring advisers to file Form PF within one business day of a reporting event is a significant departure from current Form PF reporting requirements, which range from 15 days after the end of the quarter for large liquidity fund advisers to 120 days after the end of an adviser's fiscal year for advisers with hedge funds over $150 million in RAUM. We are concerned that requiring almost immediate reporting of information that requires quantitative and qualitative analysis will be counterproductive. Advisers will be required to devote significant resources to an immediate reporting requirement at a time when the very issue being reported should be the focus of their attention. In addition, many of the proposed one-day reporting events will be triggered under circumstances that are ordinary course events that are not indicative of systemic risk and that do not raise investor protection concerns.

An immediate reporting requirement with respect to complicated calculations and judgment calls may lead to significant over-reporting. Advisers may err on the side of caution and make a filing even where none is required or in circumstances that do not present any systemic risk or investor risk in order to avoid missing the one-day deadline. Such "false positives" will not further the FSOC and the Commission's goals of identifying areas of systemic risk or investor protection. Indeed, such reporting would take time and resources from advisers to private funds and also the Commission's Staff, who will be tasked with reviewing and following up on such

[2] *Id.* at 11.

reports. False positives may also delay the Staff's recognition of any information that might truly raise systemic risk or investor protection concerns.

We expect that reporting in many instances would require a narrative explanation and potential multiple reports to provide information as it is gathered and analyzed. The Commission has suggested as much by giving advisers an opportunity to provide a narrative response, at their discretion, in Item K of Section 5 for hedge fund advisers and Item E of Section 6 for private equity advisers.[3] Indeed, in scenarios where a reporting event is more easily triggered, the information reported may not be particularly useful to the Commission without additional context. The one-day filing deadline risks that such information is inaccurate or incomplete because advisers must analyze significant data and make judgment calls as they analyze the potential reporting event and prepare a narrative.

For example, the Proposed Amendments would require large hedge fund advisers to file a report under Section 5, Item B, within one business day after experiencing an extraordinary investment loss defined as a loss equal to or greater than 20% of a fund's most recent net asset value ("NAV") over a rolling 10 business day period.[4] While we address this reporting event in more depth in Section IV below, we note that a fund may experience a loss like this for a number of reasons that present no systemic or investor concerns. Unlike some of the other items, Item B does not include any explanatory checkboxes; thus, the only way for an adviser to provide context on this reporting event would be to provide a narrative in Item K. We believe it would often be challenging for advisers to identify the need for such a filing and prepare a useful explanatory narrative within one day.

We further note that the Items that include checkboxes to provide additional context do not necessarily "obviate the need for advisers to provide narrative responses."[5] This is particularly true for the reporting events for which a wide range of underlying circumstances may trigger the event. For example, the Proposed Amendments would require advisers to file a report under Item H when there is a "significant disruption or degradation" of the reporting fund's "key operations."[6] As noted by the Commission, this reporting requirement could be triggered by a number of different scenarios from cybersecurity events that disrupt trading volume and operational issues at a service provider that affect the ability to value assets, to widespread power outages that affect operations.[7] The proposed checkboxes seek information on: (1) whether the operation occurred internally, occurred at a service provider or is related to an event outside of the adviser's control (e.g., natural disaster); (2) whether the adviser has initiated a disaster recovery or business continuity plan relating to the operation event; and (3) whether the event impacts trading, valuation, risk management or the adviser's ability to comply with applicable laws and regulations. While these checkboxes provide some information to the Commission about the underlying events, we expect advisers will want to provide context to such responses.

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[3] *Id.* at 42, 51.

[4] *Id.* at 15.

[5] *Id.* at 14.

[6] *Id.* at 34.

[7] *Id.* at 15.

In light of the foregoing concerns about the one-day reporting requirements, we suggest the Commission consider a requirement that advisers file Item 5 and Item 6 reports "promptly" after a reporting event has been triggered. Importantly, this standard will still allow the Commission to receive timely information. It will also provide advisers with more time to fully assess the underlying circumstances of a reporting event and provide a more meaningful explanation to the Commission, when necessary, which could be crucial to helping the Commission identify areas of systemic risk or investor protection. We are concerned that with too many false positives and without the benefit of additional context, the Commission's Staff will be inundated with filings to review. Not only will Commission resources be taxed, but the risk that the FSOC and the Commission miss the information that actually signals a systemic risk or investor protection issue may be increased.

A "prompt" reporting requirement would give advisers the ability to sufficiently analyze the circumstances and report them to the Commission in a manner that will provide the Staff with fewer false positives and more useful information about the underlying circumstances. We believe the "prompt" reporting standard the Commission utilizes for amendments to Form ADV and Form 13H would be useful in this context. Form ADV requires advisers to file other-than-annual amendments "promptly" if certain changes in the adviser's business cause the disclosures to be either materially inaccurate or inaccurate in any way.[8] Form 13H requires large traders to file initial filings promptly after effecting transactions that reach the identifying activity level and to file amendments promptly following the end of a calendar quarter in the event that any information becomes inaccurate for any reason.[9]

In adopting the "prompt" reporting requirement for Form 13H, the Commission noted that this standard "emphasizes the need for filings to be submitted without delay . . . while affording filers a limited degree of flexibility."[10] Similarly, in the Form NRSRO final release, the Commission noted that "whether an amendment is furnished promptly will depend on the facts and circumstances such as the amount of information being updated."[11] Here, a "prompt" reporting standard for the Proposed Amendments would similarly allow flexibility based on the facts and circumstances and provide the Commission with more accurate and complete filings where a reporting event has actually occurred.

III. Reporting Events for Hedge Fund Advisers

Proposed Section 5 of Form PF would require large hedge fund advisers to qualifying hedge funds with a NAV of at least $500 million to file reports with the Commission when their funds experience certain events that the Commission believes are indicators of hedge fund or industry stress and systemic risk. These events include circumstances involving: (1) extraordinary investment losses; (2) margin, collateral or equivalent increase; (3) notice of margin default or

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[8] *Form ADV: General Instructions* 3–4, SEC (last visited March 17, 2022), available at https://www.sec.gov/about/forms/formadv-instructions.pdf.

[9] *Large Trader Reporting*, Release No. 34-64976; File No. S7-10-1 at 38, 101–102.

[10] *Id.* at 38.

[11] *Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations*, Release No. 34-55857; File No. S7-04-07 at 15–16.

determination of inability to meet a call for margin, collateral or equivalents; (4) counterparty default; (5) material change in relationship with prime broker; (6) changes in unencumbered cash; (7) operations events; (8) withdrawals and redemptions; and (9) inability to satisfy redemptions or suspension of redemptions.[12] We believe that the triggering thresholds may result in a high number of false positives. As discussed below, we respectfully suggest the Commission make the following changes to the Section 5 reporting events:

- Change the time period for measuring "extraordinary investment loss" from a rolling 10 business days to instead use the month-end NAV;

- Change the trigger for the "operating events" such that the event is keyed to the triggering of the adviser's business continuity plan;

- Narrow the withdrawals and redemptions reporting event so that a report is required only when 50% of the NAV is due to be paid out within one year;

- Narrow the change in prime broker relationship reporting event so that a report is required only when the prime broker or the fund terminates the relationship for default or breach of the agreement; and

- Remove the reporting events with respect to margin, counterparty defaults and changes in unencumbered cash, or alternatively, adopt a materiality standard that would require advisers to report on these events when they create a material risk of the fund suffering a loss of 50% or more, as compared to its most recent monthly NAV.

A. Extraordinary Investment Loss

Proposed Item B would require hedge fund advisers to file a report upon experiencing a loss equal to or greater than 20% of a fund's most recent NAV over a rolling 10 business day period.[13] The fund's losses would be compared to its "most recent NAV," that is, the NAV reported as of the data reporting date at the end of the reporting fund's most recent Form PF reporting period,[14] which for large hedge fund advisers may be annual or quarterly. We suggest changing the time period for measuring "extraordinary investment loss" to monthly. We believe that loss determined at the end of each month would serve as a better indicator of a potential systemic risk or investor protection concern because this time period will incorporate monthly valuation changes. If the Commission is seeking to identify sudden, significant losses of a fund or the market it operates in, then a month-over-month NAV comparison would be a more timely representation of a fund's performance than a daily NAV compared against a quarterly NAV that could be up to 92 days old. Thus, we believe that monthly NAV comparisons would provide the Staff with more useful information.

[12] Proposing Release at 13.

[13] *Id.* at 15.

[14] Form PF: Glossary of Terms at 8.

Because the NAV is typically struck monthly, there will be a single date on which investment losses from the prior month are measured, as opposed to looking back to the valuation as of the end of the prior quarter. In light of this shorter time frame, we believe that a trigger of 33.33% would be a better indication of potential risk.

The Proposed Amendments would in effect mandate daily NAV calculations in order for advisers to determine whether they have met the reporting threshold. Most hedge funds calculate NAV monthly. Many advisers use administrators and third–party valuation agents to assist in the valuation process and many utilize internal valuation committees.[15] Daily NAV calculations would be a very different approach separate from, and in addition to, the adviser's existing practices. Daily NAV calculations are inconsistent with the valuation processes needed for Level 2 and Level 3 assets. Additionally, as the number of days between a fund's daily NAV and the most recent NAV reported on the last quarterly Form PF increases, the extraordinary investment loss calculation will become more detached from what a fund's NAV is actually experiencing.

B. Operations Events

Proposed Item H would require hedge fund advisers to file a report upon experiencing a "significant disruption or degradation" of the reporting fund's "key operations," which includes operations necessary for the investment, trading, valuation, reporting, and risk management of the reporting fund.[16] Under the Proposed Amendments, a "significant disruption or degradation" would mean a 20% disruption or degradation of normal volume or capacity whether as a result of an event at the reporting fund, the adviser or other service provider to the reporting fund.[17] We believe the standards identified in the Proposing Amendments would make it difficult for advisers to determine whether a reporting event has occurred and may lead to over-reporting and false positives.

Hedge fund advisers employ a wide range of strategies, and their operations vary widely depending on the strategy. For example, the "investment, trading, valuation, reporting and risk management" at an active securities trading firm looks much different from that of a direct lending firm or a firm focused on quantitative trading. Advisers will not know what a 20% degradation means in these very different contexts. Both advisers and the Commission's Staff will need to spend substantial time and effort analyzing what constitutes a reporting event in these very different circumstances. While they are all grouped together as "key operations," with different investment strategies the significance of some disruption in each of these areas would mean very different things. The reporting that the Commission and the FSOC receive on operations events would likely be difficult to utilize because of the differences in how advisers evaluate the reporting requirements.

We suggest as an alternative approach that the reporting requirement under Item H be triggered by the initiation of a business continuity plan. Across different advisers with different strategies and operations, the initiation of a business continuity plan would provide a more

[15] Breslow, et al., HEDGE FUNDS: FORMATION, OPERATION AND REGULATION, § 4.11 Valuation (2019).

[16] Proposing Release at 34–35.

[17] *Id.*

consistent indication of a potentially material event affecting the adviser's operations. A clearer standard will reduce the risks of over-reporting and false positives. It would also make the information reported from fund to fund more consistent, which would make the reports more useful to the Commission and the FSOC.

C. Withdrawals and Redemptions

The Proposed Amendments would require large hedge fund advisers to report cumulative withdrawals (or redemptions) for qualifying hedge funds within one business day of the date on which net withdrawal requests exceeded 50% of the fund's most recent NAV.[18] In many cases, hedge fund advisers include liquidity features in a fund's governing documents that are designed to prevent withdrawal requests from forcing the kind of "fire sale" of assets that the Commission has identified as raising systemic risk and investor protection concerns. Lock-up periods of two or three year periods with annual liquidity thereafter are common. An increasing number of new fund launches are "hybrid" funds, where the fund is structured to hold both liquid and illiquid assets and includes "private equity lite" terms, such as longer lock-up periods.[19] Therefore, the actual payment of net withdrawal requests exceeding 50% of a fund's most recent NAV is likely to take place over an extended period of time and does not present the immediate risks that might be present with more frequent liquidity.

In light of the foregoing, we suggest that the Commission require reporting on Form PF when withdrawal requests exceeding 50% of a fund's most recent NAV are due to be paid out within one year. Including the one-year qualifier for this reporting event would more accurately capture the Commission's concerns regarding fund liquidity and forced asset sales, as the occurrence of these events would reflect the liquidation of a fund or the potential circumstance where a fund's liquidity features do not prevent significant withdrawals from taking place in a very short time frame.

D. Material Change in Prime Broker Relationships

The Proposed Amendments would require large hedge fund advisers to report a material change between the reporting fund and a prime broker within one business day.[20] We are concerned that the material change trigger under the Proposed Amendments is overly broad and should instead require reporting only when the prime broker or the fund has terminated the relationship for default or breach of the agreement. Under the Proposed Amendments, reporting would be required for changes to the prime brokerage relationship that reflect ordinary course investment activity or termination of the prime brokerage relationship in the ordinary course of business. Instead, limiting the reporting event trigger to instances where the prime broker or the fund terminated the relationship because of default or breach of the agreement would be a better signal of potential fund distress. In addition, we note that large hedge fund advisers are typically "large traders" that are already required to amend their Form 13H at the end of each calendar quarter

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[18] *Id.* at 38–39.

[19] *Midyear Update – Trends in Hedge Funds*, Schulte Roth & Zabel (July 1, 2021), available at https://www.srz.com/resources/midyear-update-trends-in-hedge-funds.html.

[20] Proposing Release at 29–30.

when information within the filing becomes inaccurate for any reason,[21] which includes the addition or removal of a fund's prime brokers.

E. Margin Events, Counterparty Defaults and Changes in Unencumbered Cash

The Proposed Amendments would require large hedge fund advisers to report on certain changes in margin requirements, counterparty default and changes in unencumbered cash within one business day. Specifically, advisers would be required to report (1) a cumulative increase in a fund's margin of more than 20% of the fund's most recent NAV over a rolling 10 day business period, (2) a fund's margin default or inability to meet a call for margin, collateral or equivalent and (3) a counterparty's margin default.[22] Advisers would also be required to report a significant decline in a fund's holdings of unencumbered cash by more than 20% of the fund's most recent NAV over a rolling 10 business day period.[23] Each of these events can occur for a variety of reasons unrelated to systemic risk or investor protection concerns. We suggest removing these events from the Proposed Amendments because we believe that such reporting will lead to a significant number of false positives; we believe that systemic risk and investor protection concerns are better captured by other proposed events.

Margin. Changes to margin occur for a number of reasons unrelated to systemic risk or investor protection, including establishment of a new investment position, use of a new investment strategy or substantial new subscriptions. Indeed many increases in margin reflect the success of the fund, not an indication of its potential failure. The requirement to disclose extraordinary investment losses is a more practical way of identifying potential systemic risk or investor protection concerns.

Counterparty Defaults. Private fund advisers enter into transactions with various counterparties and often negotiate default terms that will provide them with maximum leverage. Requiring advisers to immediately report any such default would lead to a potentially significant number of false positives. If such reporting is intended to gather information about the potential inability of banks or broker-dealers to meet their obligations, then the FSOC would seem to be better served by direct reporting by those regulated firms.

Unencumbered Cash. Changes in unencumbered cash occur for numerous reasons unrelated to systemic risk or investor protection concerns including significant subscriptions and redemptions and the establishment of new investment provisions. The requirement to disclose extraordinary investment losses is a more practical way of identifying potential systemic risk or investor protection concerns.

Alternatively, if the Commission believes it would be useful to receive reporting on Form PF with respect to these events, we suggest that the Commission adopt a materiality standard that would require advisers to report on changes in margin, counterparty defaults and unencumbered

[21] *Large Trader Reporting*, Release No. 34-64976; File No. S7-10-1 at 3.

[22] Proposing Release at 21–24.

[23] *Id.* at 31–32.

cash that create a material risk of the fund suffering a loss of 50% or more, as compared to its most recent monthly NAV.

IV. Reporting Events for Private Equity Fund Advisers

The Proposed Amendments would require all advisers to private equity funds to file reports within one business day upon the triggering of the following reporting events: (1) execution of an adviser-led secondary transaction, (2) implementation of a general partner or limited partner clawback and (3) removal of a fund's general partner, termination of a fund's investment period or termination of a fund.[24]

In adopting the Form PF filing requirements in 2011, the Commission considered the appropriate timing of reporting by advisers to private equity funds and determined that "the generally illiquid nature of the private equity fund portfolios means that trends emerge more slowly in that sector."[25] Because of this, the Commission required advisers to large private equity funds to report information on an annual, as opposed to a quarterly, basis. In proposing one-day reporting requirements on advisers to private equity funds, the Commission now cites the increasing number of such funds and their net assets.[26] But the illiquid nature of private equity funds' investments has not changed in the intervening years, and we do not believe that any of the new triggering events that would have to be reported in one business day involves a degree of urgency that would support such a requirement. The reporting events under the Proposed Amendments are unlikely to reflect a sudden and recent market event but instead some event that already occurred in the past or was realized slowly over time. We are concerned this would lead to over-reporting of stale or immaterial information to both the FSOC and the Commission.

A. Adviser-led Secondaries

The Proposed Amendments would require all private equity fund advisers to file a report within one business day of the execution of an adviser-led secondary transaction, for the purpose of aiding the Commission in monitoring potential conflicts of interest that could negatively impact investors.[27] However, conflict approval is a term commonly contemplated in a private equity fund's governing documents, such as a fund limited partnership agreement (or similar agreement). In the event of a conflict related to a secondary transaction, a general partner is required to disclose and seek approval of the conflict with the fund's limited partners, and limited partners are empowered with the ability to dissent to the transaction before the transaction takes place. Because the execution of an adviser-led secondary transaction is typically approved by or on behalf of limited partners, requiring each transaction to be reported on Form PF could potentially result in a high number of filings made to the Commission that are not indicative of investor protection issues.

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[24] *Id.* at 43.

[25] *Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF*, Advisers Act Release No. 3308 (Oct. 31, 2011), [76 FR 71128 (Nov. 16, 2011)] at 53.

[26] Proposing Release at 88–89.

[27] *Id.* at 45.

B. Clawbacks

The Proposed Amendments would require all private equity fund advisers to report clawbacks of distributions made to a fund's general partner or limited partners.[28] Private equity funds are currently trending toward using European-style waterfalls, where carried interest calculations are made at the end of a fund's life and based on aggregate returns from all investments disposed by the fund. Therefore, if the general partner makes a distribution after disposing of an investment early in the investment period, and subsequently suffers an investment loss, it is very possible that the subsequent investment loss would require the clawback of the distribution made to the general partner. This is simply a timing issue for distributions made at the general partner's discretion and demonstrates the very reason why clawbacks are included in private equity fund governing documents. Further, because private equity funds typically have investment periods lasting five or more years, and terms lasting ten or more years, the distribution that is returned under a clawback is likely to have occurred years in the past.

C. Certain Changes to Funds

The Proposed Amendments would require one-day reporting of the removal of the fund's general partner, the termination of the fund's investment period or the termination of the fund.[29] Requiring one-day reporting of such events would add little value to the monitoring of systemic risk or the identification of investor protection concerns. Fund limited partnership agreements (or similar agreements) typically grant limited partners with a variety of options for removing the general partner or terminating the investment period of a private equity fund or otherwise terminating the private equity fund entirely. Such options for removing the general partner or terminating the fund or investment period often include "no fault removal" or "no fault termination" by limited partner vote. Furthermore, termination of a fund's investment period does not lead to liquidation of the fund's existing investments. Therefore, if the Commission chooses to keep this reporting event, we suggest that the Commission narrow the reporting event to be triggered by "for cause" events only.

While rare, a limited partner who has lost confidence in the general partner's ability to generate a successful investment program can, and typically will, address these concerns through private causes of action. Limited partners also have the ability to alert the Commission if they believe the general partner is behaving poorly. In most cases, these triggers will be specific to a particular private equity fund adviser and, in any event, they are the result of the application of carefully crafted provisions in the fund's governing documents that were agreed to by limited partners. In addition, even if there were events at a private equity fund that led to these reporting triggers, the events themselves likely would have been long past by the time the reporting trigger occurred.

In light of the foregoing, we respectfully request that the Commission remove these new reporting requirements from the Proposed Amendments or, in the alternative, require the reporting of such information as part of the annual Form PF filing required of private equity advisers. We

[28] *Id.* at 47.

[29] *Id.* at 50.

believe that these proposed one-day Form PF reporting events are not necessary to protect the interests of limited partners in light of the well-developed contractual architecture of these funds.

V. Threshold for Large Private Equity Advisers

The Proposed Amendments would reduce the filing threshold for Section 4 of Form PF for large private equity advisers from $2 billion in combined RAUM to $1.5 billion RAUM. We expect that the costs of compliance with these reporting requirements will weigh heavily on smaller players within the industry. Increased management fees to cover the cost of compliance with the additional reporting requirements would drive down performance and could limit competition, as the smaller private equity advisers find it more difficult to compete against larger advisers, which can absorb the costs related to the additional filing requirements more easily due to scale. We believe that instead of protecting investors, these efforts could harm investors by reducing their returns and the number of private funds in which to invest.

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We would be pleased to respond to any inquiries you may have regarding our letter or our views on the Proposed Amendments more generally. Please feel free to direct any inquiries to Marc Elovitz, Kelly Koscuiszka, Phyllis Schwartz or Joseph Smith at (212) 756-2000.

Respectfully submitted,

SCHULTE ROTH & ZABEL LLP

cc: The Honorable Gary Gensler
The Honorable Caroline Crenshaw
The Honorable Allison Herren Lee
The Honorable Hester Peirce
William Birdthistle, Director, Division of Investment Management