On August 10, 2022, the US Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC) issued a joint proposal to amend Form PF,[1] a reporting form for SEC-registered reporting private fund advisers to require enhanced periodic disclosures.

**Form PF**

Form PF was designed to aid regulators in spotting stability risks. Fund advisors are...
required to file Form PF if (1) they are registered or required to register with the SEC as an investment advisor; (2) they manage one or more private fund; and (3) the advisor and related persons have at least $150 million in private fund assets under management. Commodity pool operators and commodity trading advisors that satisfy these conditions must file Form PF with respect to any commodity pool they manage that is a private fund.

Proposal

The proposal cites an upward trend in certain investment strategies, including credit, digital asset, litigation finance, and real estate strategies, as a motivation for amending Form PF. The SEC has also noted the growth in the size and systemic significance to the financial system of private funds’ assets under management.

The amendments are designed to enhance the Financial Stability Oversight Council’s (FSOC) ability to locate systemic risks and increase the SEC’s oversight of the otherwise opaque but rapidly growing ecosystem of private funds, in the name of fair, orderly, and efficient markets. FSOC is expected to use the expanded information collection to determine how to deploy its regulatory tools.

The proposal amends the general instructions and basic information reporting requirements for all categories of private fund advisors, including advisors to hedge funds, private equity funds, real estate funds, securitized asset funds, liquidity funds, and venture capital funds. The proposal also clarifies instructions and definitions in the pursuit of enhancing the data collected from Form PF.

Reporting by Large Hedge Fund Advisors on Qualifying Hedge Funds

The proposed amendments will alter reporting by large hedge fund (those with over $500 million of net assets) advisors on qualifying hedge funds. In order to improve data quality, the proposed new form would impact how large hedge fund advisors report:

- investment exposures;
- borrowing and counterparty exposure;
- market factor effects;
- currency exposure reporting (including cryptocurrency);
- turnover;
- country and industry exposure;
- central clearing counterparty reporting;
- risk metrics;
- investment performance by strategy;
- portfolio correlation;
• portfolio liquidity; and

• financing liquidity.

The proposal also removes aggregate reporting and amends reporting timelines to require large hedge fund advisors and large liquidity fund advisors to update Form PF within a certain number of days after the end of each calendar quarter, as opposed to each fiscal quarter as currently required by Form PF.

**Reporting on Private Fund Advisors**

The proposed amendments will impact reporting by private funds and their advisors. To help in identifying trends that may reveal systemic risks, the amended Form PF would require additional information, including:

- identifying information, including private fund assets, advisor and related persons, financing, investor concentration, and performance;
- reporting master-feeder arrangements and parallel fund structures separately;
- specific rules for trading vehicles;
- private fund assets under management;
- withdrawal and redemption rights;
- gross asset value and net asset value;
- inflows and outflows;
- base currency;
- borrowings and types of creditors;
- fair value hierarchy;

• beneficial ownership, specifically whether owners[2] are US persons or non-US persons; and

• fund performance.

**Amend Reporting Concerning Hedge Funds**

The proposed amendments will require private funds to report more detail on their investment strategies, counterparty exposure, and the trading and clearing mechanisms employed by hedge funds.

**Investment Strategies**

The amended Form PF would require advisors to indicate which investment strategies best describe the reporting fund’s strategies on the last day of the reporting period, rather than allowing advisors the flexibility to report information as of the data reporting date or throughout the reporting period, as is currently
allowed by Form PF. Also, the amended form would have updated strategy categories. For example, equity strategies would be updated to include categories like factor driven, statistical arbitrage, and emerging markets. Credits strategies would be updated to include categories like litigation finance, emerging markets, and asset-backed/structured products.

Counterparty Exposures

The amended Form PF would require hedge fund advisors to prepare a “consolidated counterparty exposure table” describing the exposure (1) the reporting fund has to creditors and counterparties and (2) creditors and other counterparties have to the reporting fund. Advisors would report the US dollar value of the reporting fund’s “borrowing and collateral received,” as well as its “lending and posted collateral,” aggregated across all counterparties, as of the end of the reporting period.

Trading and Clearing Mechanisms

The amended Form PF would require advisors to report (1) the value traded and (2) the value of positions at the end of the reporting period. Also, the amended form would require advisors to report information about trading and clearing mechanisms for transactions in interest rate derivatives separately from other types of derivatives.

Focus on Digital Asset Investments

The proposed amendments seek to collect information on funds’ exposures to digital assets in order to better understand their overall crypto market exposures, rather than account for digital assets in the “cash and cash equivalents” line item Form PF currently includes. The proposal defines “digital asset” as an asset that is issued and/or transferred using distributed ledger or blockchain technology, including crypto assets like virtual currencies, coins, and tokens.

These inquiries may foreshadow the future of digital asset regulation. For example, the proposal considers requiring advisors to report digital assets by name (e.g., Bitcoin, Ethereum), and whether disclosure of the nature of each digital asset holding should be required, e.g., the rights a digital asset provides to a holder.\[3\] This could include whether the digital asset represents a right to exchange for fiat or even other assets (including other digital assets).

The questions posed in the proposal touch upon whether there should be a distinction between digital assets, in which the redemption obligation is supported by an unconditional guarantee of payment, such as “central bank digital currencies,” and digital assets that are redeemable upon demand from the issuer, whether collateralized by a pool of assets or, with respect to specific representations of the digital assets, potentially encompass, \textit{inter alia}, stablecoins.

Additionally, the proposal considers whether there should be a distinction with respect to digital assets that “do not represent any direct or indirect obligation of any party to redeem or those that represent an equity, profit, or other interest in an entity,” which could encompass, \textit{inter alia}, DAO tokens.
The proposal explains that regulators are looking for digital assets to be clearly defined to ensure accurate reporting, aid in deployment of regulatory tools, and improve investor protection, particularly in wake of the emergence, exponential growth, and espousal of blockchain technology-based assets in the past 10 years since the form was last updated.

Conclusions

The enhanced disclosure requirements introduced by the SEC and CFTC joint proposal have already met resistance from the private fund industry, based on cost of increased disclosure, confidentiality and security concerns, and a concern that the proposal could be only the beginning of an enhanced regulatory regime requiring private funds to adhere to more onerous reporting requirements, specifically to disclose granular information about their exposure to certain investments such as digital assets.

Some Proposed Amendments Generally Target the Quality of Data Collected

For example, information required to be expressed as a percentage would be rounded to the nearest one hundredth of one percent rather than the nearest whole percent.

Another such amendment requires that advisors report separately each component fund of a master-feeder arrangement and parallel fund structure, except where a feeder fund invests all its assets in a single master fund or disregarded feeder fund. An advisor could continue to aggregate these structures to calculate whether the reporting threshold has been met. And another amendment would require advisors to indicate which investment strategies best describe the reporting fund’s strategies on the last day of the reporting period, as opposed to the current flexible reporting standard.

Other Amendments Aim to Clarify the Requirements of the Form PF Instructions

Under the proposal, Form PF would now explicitly continue to permit an advisor to include or exclude the value of investments in other private funds to calculate whether the advisor meets the thresholds for reporting as a large hedge fund advisor, large liquidity fund advisor, or large private equity advisor and whether a hedge fund is a qualifying hedge fund.

Another amendment would provide clarification to advisors on how to report information if the reporting fund uses a trading vehicle. Another instruction clarification would direct advisors to exclude the value of private funds’ investments in other internal private funds to avoid double counting fund assets. Yet another proposed amendment creates more granular categories for equity strategies, such as factor driver, statistical arbitrage, and emerging markets.

The More Significant Changes Add Detail to Certain Categories of Investments, Including Digital Assets

The joint-proposed amendments to Form PF do not come without controversy, including from within the agencies themselves.[4] Given the broad implications of
isolating digital assets beyond those for large investments advisors and qualified hedge funds that are required to report on Form PF, a finalized Form PF is poised to send ripples across the sea of digital assets.

As the first major law firm to purchase land in the metaverse, ArentFox Schiff is closely monitoring the emerging regulatory landscape and any related developments at the SEC, CFTC, and other governmental agencies aiming to regulate the crypto/digital asset space.

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**FOOTNOTES**


[2] Beneficial owners that are broker dealers, insurance companies, non-profits, pension plans, banking, or thrift institutions.
