

**U.S. Securities and Exchange Commission**

**Annual Staff Report Relating to the Use of Data  
Collected from Private Fund Systemic Risk Reports**



This is a report of the Staff of the Division of Investment Management  
of the U.S. Securities and Exchange Commission.

The Commission has expressed no view regarding  
the analysis, findings, or conclusions contained herein.

August 23, 2016

## Executive Summary

The Dodd-Frank Act directed the Commission to require registered investment advisers to maintain records and file reports regarding the hedge funds, private equity funds, and other private funds they advise. The Commission implemented this aspect of the Dodd-Frank Act in 2011 when it adopted a form (Form PF) that requires certain registered investment advisers that advise private funds to report information to the Commission.

While the primary aim of this Dodd-Frank provision was to create a source of data for the Financial Stability Oversight Council (FSOC) to use in assessing systemic risk, the Commission, as provided by the Dodd-Frank Act, is using the information to support its own regulatory programs, including examinations, investigations, and investor protection efforts relating to private fund advisers. The Dodd-Frank Act also required that the Commission report annually to Congress on how it has used the data to protect investors and the integrity of the markets. This is the fourth annual report submitted to Congress to satisfy this obligation.

During the past year, the Commission's staff has focused its efforts on using Form PF data: (i) in examinations and investigations of private fund advisers; (ii) in the Commission's risk monitoring activities; (iii) to inform regulatory initiatives; and (iv) when working with other federal regulators and international organizations in areas of mutual interest relating to private fund advisers.

Additionally, staff of the Division of Investment Management began publishing quarterly reports in October 2015 that include highly aggregated information and statistics that private fund advisers have reported to the Commission on Form PF. Appendix A, attached, is a copy of the most recent version of the staff's quarterly report.

## I. Introduction

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act)<sup>1</sup> Section 404 directed the U.S. Securities and Exchange Commission (Commission) to establish reporting requirements for investment advisers to private funds as necessary and appropriate in the public interest and for the protection of investors or for the assessment of systemic risk by the Financial Stability Oversight Council (FSOC).<sup>2</sup> The Dodd-Frank Act specifies that such reporting must include certain information about private funds, including but not limited to the amount of assets under management, use of leverage, counterparty credit risk exposure, and trading practices for each private fund managed by the adviser.<sup>3</sup> In 2011, the Commission adopted Form PF and Advisers Act rule 204(b)–1 that established filing requirements for private fund advisers regarding information for the assessment of systemic risk.<sup>4</sup>

The Commission is required to submit an annual report to Congress regarding how the Commission has used the data collected regarding private funds under the Dodd-Frank Act to protect investors and the integrity of the markets.<sup>5</sup> This report is being submitted to Congress in satisfaction of that requirement. This is a report of the Staff of the Division of Investment Management, and the Commission has expressed no view regarding the analysis, findings, or conclusions contained herein.

## II. Background

The Commission adopted Form PF to obtain, on behalf of FSOC, data that FSOC can use to monitor systemic risk in U.S. financial markets. Form PF was designed in consultation with FSOC members and their staffs and provides FSOC and the Commission with information about the operations and strategies of private funds.<sup>6</sup> Investment advisers registered, or required to be

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<sup>1</sup> Public Law 111-203, 124 Stat. 1376 (2010).

<sup>2</sup> Section 404 of the Dodd-Frank Act. Public Law No. 111-203, § 404, 124 Stat. 1376, 1571-74 (2010) (codified at Section 204(b) of the Investment Advisers Act of 1940, as amended (“Advisers Act”). FSOC was created pursuant to the Dodd-Frank Act to monitor risks to the U.S. financial system. *See* Dodd-Frank Act sections 111 and 112.

<sup>3</sup> Section 404 of the Dodd-Frank Act.

<sup>4</sup> *See* Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF, Investment Advisers Act Release No. 3308 (October 31, 2011), 76 FR 71128 (November 16, 2011) (“Adopting Release”). In 2012, the CFTC adopted rule 4.27 under the Commodity Exchange Act to implement systemic risk reporting requirements for registered commodity pool operators (“CPOs”) and commodity trading advisors (“CTAs”); the rule also permits CPOs and CTAs registered with the CFTC that are registered with the Commission as investment advisers to file Form PF with the Commission in lieu of filing certain systemic risk reports with the CFTC. *See* Commodity Pool Operators and Commodity Trading Advisors: Amendments to Compliance Obligations, 77 FR 11252 (February 24, 2012).

<sup>5</sup> Section 404 of the Dodd-Frank Act.

<sup>6</sup> To implement the reporting requirements, the Commission developed an electronic filing system, the Private Fund Reporting Depository (PFRD) through which advisers submit the information required by Form PF to the Commission. PFRD is operated under contract with the Financial Industry Regulatory Authority (FINRA) as an extension of the existing Investment Adviser Registration Depository (IARD)

registered, with the Commission that have at least \$150 million in private fund regulatory assets under management (RAUM)<sup>7</sup> are required to periodically file Form PF with the Commission. The amount of information required to be reported and the frequency with which Form PF must be filed depend on the amount of the adviser's RAUM and the types of private funds managed.

Most advisers are required to file Form PF once a year and report only basic information regarding the private funds they advise. This annual filing requirement includes general data such as the types of private funds that an adviser advises (e.g., private equity or hedge funds) and information relating to such funds' size, leverage, types of investors, liquidity, and performance. Advisers managing hedge funds also must report information about fund strategy, counterparty credit risk, and the use of trading and clearing mechanisms.

Large private fund advisers, however, must provide more detailed information. The content and frequency of this more detailed reporting is different depending on the type of private funds the large adviser manages. For example, advisers with at least \$1.5 billion in hedge fund RAUM must file Form PF quarterly and provide aggregate information on their hedge funds' exposures, geographical concentrations, and turnover by asset class (but not position-level information). In addition, for each Qualifying Hedge Fund (i.e., \$500 million or more in net assets), advisers provide additional information. Advisers with at least \$1 billion in combined liquidity fund and registered money market fund RAUM must file Form PF quarterly and provide information regarding their liquidity funds' exposures, geographical concentrations, turnover by asset class, and direct and indirect forms of leverage and liquidity.<sup>8</sup> Advisers with at least \$2 billion in private equity fund RAUM must file Form PF annually and provide additional information relating to their private equity funds' use of direct and indirect leverage and investments in financial institutions.

The Dodd-Frank Act provides specific confidentiality protections for proprietary information of private fund investment advisers collected by the Commission on Form PF. Consistent with the enhanced confidentiality provisions established under the Dodd-Frank Act, Commission staff has designed and implemented controls and systems for the handling of Form PF data across the agency. Senior staff members from various Divisions and Offices within the Commission are members of a Steering Committee that is tasked with developing and overseeing a consistent and agency-wide approach to accessing, and the using, sharing, and security of, Form PF data.

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system (the online reporting platform advisers use to register on Form ADV with the Commission). *See* Adopting Release at Section II.E.

<sup>7</sup> RAUM is defined, for a private fund, as the private fund's gross assets plus any uncalled capital commitments. *See* Form PF: Glossary of Terms; *see also* Instruction 5.b for Form ADV: Instructions for Part 1A.

<sup>8</sup> The Commission adopted amendments to Form PF to obtain additional information regarding private liquidity funds in conjunction with amendments to rules for registered money market funds. Money Market Fund Reform; Amendments to Form PF, Securities Act Release No. 9616 (July 23, 2014), 79 FR 47736 (August 14, 2014) ("Money Market Fund Reform Release").

### III. How the Commission Uses PF Data

The information collected on Form PF primarily is intended to assist FSOC in its systemic risk monitoring obligations under the Dodd-Frank Act. To that end, the Form PF database was made available to FSOC through the Office of Financial Research (OFR) in 2013, subject to agreement regarding appropriate use and confidentiality protections of Form PF data by OFR.<sup>9</sup>

In addition, the Commission is using information obtained from Form PF in its regulatory programs and investor protection efforts relating to private fund advisers.<sup>10</sup> As more fully discussed below, within the Commission, Form PF data principally is used by the Office of Compliance Inspections and Examinations (OCIE), the Division of Economic and Risk Analysis (DERA), the Division of Enforcement (Enforcement), and the Division of Investment Management (IM). A copy of the most recent version of a quarterly report by the staff of the Division of Investment Management concerning private fund industry statistics and trends can be found in the attached Appendix A. These quarterly reports, which the staff began publishing in October 2015, include highly aggregated information and statistics that private fund advisers have reported to the Commission on Form PF.

During the past year, the Commission primarily used Form PF data in examinations of registered investment advisers to private funds. In addition, the Commission used Form PF data in its enforcement program regarding private fund advisers. Commission staff also continued to focus its efforts on incorporating Form PF data into the Commission's risk monitoring activities, informing regulatory initiatives, and working with other federal regulators and international organizations regarding issues relating to private fund advisers.

#### *Examinations and Investigations*

The Commission staff uses Form PF data in its examination and enforcement programs regarding registered investment advisers that manage private funds. Because examination and enforcement matters are generally non-public,<sup>11</sup> the following summarizes how Form PF data has been integrated generally into examination and enforcement matters.

DERA, OCIE, and IM staff use Form PF data to help OCIE and IM identify potential examination candidates, such as private fund advisers whose activities either involve areas of specific examination focus or may present heightened compliance risks. Furthermore, prior to an examination of a private fund adviser that files Form PF, OCIE and IM staff review the adviser's Form PF filing as a part of a routine pre-examination evaluation. This review, in conjunction with other data sources, provides the staff with an understanding of the nature of an adviser's business and investment strategy. OCIE and IM staff also generally review information contained in the Form PF filing for inconsistencies with other information obtained from an adviser during an examination, such as due diligence reports, pitch books, offering documents,

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<sup>9</sup> OFR was established under the Dodd-Frank Act to support FSOC in fulfilling FSOC's purpose and duties. *See* section 152 of the Dodd-Frank Act.

<sup>10</sup> *See* Adopting Release at Section V.A.

<sup>11</sup> *See, e.g.,* Advisers Act Section 210(b).

operating agreements, and books and records. Furthermore, OCIE and IM staff typically look for discrepancies between an adviser's Form PF filing and any publicly-available documents related to the adviser, including the adviser's Form ADV and brochure. In addition to reviewing Form PF filings for background and to identify inconsistencies with other documents, OCIE staff also often reviews an adviser's Form PF filing in order to confirm that the investment strategies disclosed to investors match the information contained in the adviser's Form PF filing, particularly with respect to holdings, leverage, liquidity, derivatives, and counterparties. After completing this analysis, OCIE staff requests additional documentation from advisers to substantiate or explain any inconsistency or red flag. In some cases, this process may lead to an examination deficiency letter.

Enforcement staff also obtains and reviews the Form PF filings of certain advisers in connection with ongoing investigations. Among other Enforcement staff, the Asset Management Unit (AMU) uses Form PF data in investigations of private fund advisers.

### *Risk Monitoring*

The Commission has continued to develop the use of Form PF data in its ongoing risk monitoring activities. SEC staff in Washington, DC and in the regional offices access reports generated by DERA and IM that use Form PF data, and also access Form PF filings directly to assist in risk monitoring activities.

DERA continues to develop its suite of proprietary analytical tools (the DERA Database), including the incorporation of certain data from Form PF, to assist staff in risk monitoring activities. For example, OCIE staff in its Private Fund Unit and Office of Risk Analysis and Surveillance (RAS) queries the DERA Database and works with DERA and IM's Risk and Examinations Office (REO) to develop reports to identify advisers engaging in activities implicating particular areas of examination focus (e.g., exposures, valuations, etc.), and to identify possible red flags at firms that may trigger examinations. OCIE, DERA, and IM staff are also developing periodic reports that analyze data across a wide spectrum of filers to help identify trends and possible emerging risks in the private fund industry. In particular, as part of their ongoing monitoring of the money market fund industry, DERA and REO staff have been monitoring data reported on Form PF by private liquidity funds (an alternative to money market funds). Furthermore, REO staff reviews Form PF data to identify funds and advisers that might be particularly affected by impending or recent market or geopolitical events.

Enforcement's AMU, in partnership with OCIE, IM, DERA, and Enforcement's Center for Risk and Quantitative Analytics (CRQA), has accessed Form PF data to conduct its ongoing Aberrational Performance Inquiry (API). API, which seeks to identify hedge fund advisers that report aberrational returns relative to certain benchmarks for further investigation or examination, has resulted in the identification of fraudulent or improper conduct. Staff in OCIE and IM's REO also use Form PF data to inform engagement meetings with private fund advisers and to inform the Commission staff's general knowledge of the private fund industry.

IM, DERA, Enforcement, and OCIE staff continue to work to develop additional analytical tools and reports focusing on different types of Form PF data as their familiarity and experience with Form PF data continues to grow.

### *Regulatory Initiatives*

IM staff uses Form PF data to inform policy and rulemaking initiatives relevant to the asset management industry generally and private funds specifically. For example, IM staff found Form PF data regarding private liquidity funds informative when analyzing the money market fund reforms and amendments made to the liquidity fund section of Form PF to collect more granular data on liquidity fund holdings.<sup>12</sup> IM staff was also informed by its experiences of receiving and analyzing Form PF data when creating the proposed Form N-PORT, a portfolio holdings disclosure form for registered investment companies.<sup>13</sup>

In addition, in an effort to improve data quality, IM staff continues to respond to filer inquiries and contact filers to inform them of anomalous data that may require the submission of curative amendments to their Form PF filings.

### *Consultation*

Commission staff uses Form PF data in conjunction with other federal regulators in areas of mutual interest and in international collaborative efforts regarding private funds and their investment advisers. For example, Form PF reports have been used by Commission staff in connection with its participation in FSOC's systemic risk efforts in the private fund space, including in discussions with other federal regulators. Also, as it has done in previous years, Commission staff provided certain aggregated, non-proprietary Form PF data to the Financial Stability Board (FSB) as part of an information sharing exercise related to an FSB workstream.

In addition, the Commission has approved a Memorandum of Understanding with the Board of Governors of the Federal Reserve System (Board) that will allow the Commission to share Form PF data with the Board, provided the Board implements and follows certain protocols to ensure the confidentiality and appropriate use of such data.

## **IV. Conclusion**

During the past year, the Commission's staff has focused its efforts on using Form PF data: (i) in examinations and investigations of private fund advisers; (ii) in the Commission's risk monitoring activities; (iii) to inform regulatory initiatives; and (iv) when working with other federal regulators and international organizations in areas of mutual interest relating to private fund advisers. Additionally, IM staff began publishing quarterly reports that include highly aggregated information and statistics that private fund advisers have reported to the Commission on Form PF.

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<sup>12</sup> See Money Market Fund Reform Release.

<sup>13</sup> See Investment Company Reporting Modernization, Investment Company Act Release No. 31610 (May 20, 2015), 80 FR 33589 (June 12, 2015).

**Appendix A**

**(Private Funds Statistics, Fourth Calendar Quarter 2015)**