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Monthly Version

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NEW RULES

SEC Adopts Significant Amendments to Form PF Reporting Requirements for Private Fund Advisers

On May 3, 2023, the SEC adopted significant amendments to Form PF, the confidential reporting form used by certain SEC-registered investment advisers to private funds to report information to the SEC and the Financial Stability Oversight Council. The amendments include: (1) new quarterly event reporting requirements for advisers to private equity funds; (2) enhanced reporting requirements for large private equity fund advisers; and (3) new current reporting requirements for large hedge fund advisers. Certain of the amendments will require advisers to private funds to timely make non-routine filings with the SEC upon the occurrence of certain material events.

Generally, investment advisers registered (or required to be registered) with the SEC with at least $150 million in private fund assets under management as of the last day of the most recently completed fiscal year must file Form PF with the SEC. The Form PF amendments apply to three categories of advisers, as described below.

- **New Quarterly Event Reporting for Private Equity Fund Advisers**
  All private equity fund advisers with at least $150 million in private fund assets under management will need to report on the occurrence of any of the following events **within 60 days** of the relevant fiscal quarter-end: (1) completion of an adviser-led secondary transaction; (2) general partner removals; and (3) investor elections to terminate a fund or its investment period.
  - **"Adviser-led secondary transaction"** is defined 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. New Section 6, item B of Form PF will require private equity fund advisers to provide a brief description of the transaction and note the transaction's closing date.
- **Enhanced Reporting for Large Private Equity Fund Advisers**
  Any adviser having at least $2 billion in regulatory assets under management attributable to private equity funds as of the last day of the adviser's most recently completed fiscal year (i.e., a large private equity fund adviser) will be subject to additional annual reporting requirements. Specifically, amended Section 4 of Form PF will require annual reporting by large private equity fund advisers on the implementation of: (1) any general partner clawback; or (2) a limited partner clawback (or clawbacks) in excess of an aggregate amount equal to 10 percent of a fund's aggregate capital commitments. This reporting will include the effective date of the clawback and the reason for the clawback.

  Other amendments to Form PF will collect information about private equity fund investment strategies, additional information about fund-level borrowing, more granular information about the nature of reported events of default and bridge financing to controlled portfolio companies, and changes to a question regarding a fund's geographic breakdown of investments.
- **New Current Event Reporting for Large Hedge Fund Advisers**
  Any adviser having at least $1.5 billion in regulatory assets under management attributable to hedge funds as of the end of any month in the prior fiscal quarter (i.e., a large hedge fund adviser) will be required to file a current report on Form PF as soon as practicable upon, but **no later than 72 hours after**, the occurrence of certain events that the SEC believes may indicate significant stress or otherwise serve as signals of potential systemic risk implications. Specifically, the reportable events include:
  - Extraordinary investment losses (losses equal to or greater than 20% of a fund's aggregate value calculated over a rolling 10 business day period);
  - Significant margin and default events;
  - The termination or material restriction of a prime broker relationship;

- Any significant disruption or degradation of the reporting fund's critical operations, whether as a result of an event at a service provider to the reporting fund, its adviser or the fund itself;
    - For this purpose, "critical operations" means operations necessary for (1) the investment, trading, valuation, reporting and risk management of the reporting fund or (2) the operation of the reporting fund in accordance with federal securities laws and regulations.
- Large withdrawal and redemption requests, inability to satisfy redemptions or withdrawals requests and suspensions of redemptions or withdrawals.
    - Requests for withdrawals or redemptions exceeding 50% of the most recent net asset value (after netting against subscriptions or other contributions from investors received and contractually committed) will trigger the current reporting requirement.

Advisers to private funds should consider whether enhancements to their reporting and monitoring procedures and practices are appropriate to account for the new reporting requirements.

The new quarterly event reporting for all private equity fund advisers and current event reporting for large hedge fund advisers will be effective six months after publication of the final rule in the Federal Register. The enhanced annual reporting requirements for large private equity fund advisers will be effective one year after publication of the final rule in the Federal Register.

The SEC's adopting release is available here and a related fact sheet is available here.

GUIDANCE AND ALERTS

SEC Staff Issues Risk Alert on LIBOR-Transition Preparedness

On May 11, 2023, the SEC's Division of Examinations issued a risk alert to remind registered broker-dealers and investment advisers of the discontinuance of U.S. Dollar LIBOR (formerly the London Interbank Offered Rate) after June 30, 2023, as well as to summarize staff observations from recent examinations in relation to the transition. To assess industry preparedness for the impending cessation of LIBOR, the staff examined a variety of firms, including: (1) investment advisers associated with large banks; (2) advisers to various types of registered investment companies; (3) fund complexes of various sizes; (4) advisers to private funds that invest in private credit such as collateralized loan obligations; and (5) large retail-oriented advisers. The staff noted that efforts to prepare for the transition varied across firms based on the nature and extent of LIBOR exposure at a particular firm.

Stemming from these examinations, the risk alert summarized staff observations on how firms are managing the transition away from LIBOR in certain key areas:

- **Risk Management.** The staff observed that firms with significant exposure to LIBOR issues are treating the transition as an enterprise risk governance matter and have formed working groups to create transition plans, timelines and impact assessments. The staff similarly found that firms have made concentrated efforts on internal training and guidance to ensure that employees most impacted by the LIBOR transition, such as traders, portfolio managers and client-facing representatives, are kept informed on current developments, both generally and in relation to their firm's relevant internal policies. The staff observed that almost all examined firms are keeping informed and engaged either through membership in or reliance on guidance from the Alternative Reference Rates Committee, and that many firms are discussing the LIBOR transition with relevant industry groups.
- **Operations.** The staff observed that many firms are actively engaged with service providers, sub-advisers and third-party managers to assess their readiness for the transition. The staff further noted that firms requiring internal system updates have performed end-to-end testing to confirm their systems can accommodate alternative reference rates. The staff observed that several firms incorporated a process to reconcile settlement and payment processes in an attempt to ensure that counterparties and service providers were properly accounting for the terms and conditions of alternative reference rates.
- **Portfolio Management.** The staff observed that many firms have taken a global approach to contract identification, examining subsidiaries and affiliates for LIBOR exposure, and that many firms have engaged third-party service providers to perform substantive

reviews of fallback provisions. The staff noted that firms have developed internal controls such as pre-trade checks or purchasing guidelines relative to LIBOR-linked investments, and that firms have been converting existing bank loans and other instruments to alternative reference rates in advance of the transition date to the extent practicable.

- **Fiduciary Responsibilities and Investor Communications.** The staff observed that firms were handling fiduciary obligations differently depending on the type of LIBOR exposure involved, with large direct client exposure being addressed through the remediation of contracts and indirect client exposure managed through third-party due diligence focused on transition readiness. The staff observed that firms have assessed, disclosed and mitigated conflicts of interest relative to LIBOR transition, including in particular those related to cross-trading, principal transactions, allocations of transition costs and clients with conflicting priorities. The staff observed that firms with significant exposure have provided comprehensive disclosures of relevant risks.

- **Keeping Informed About Ongoing and New Challenges.** The staff reiterated guidance from the Alternative Reference Rates Committee that encouraged market participants to remediate as many LIBOR-linked bank loans as practicable before June 30, 2023 and noted that firms should continue to monitor industry resources for guidance and tools to assist in addressing operational challenges relative to LIBOR transition.

The SEC staff noted the significant efforts firms have made to prepare for the transition away from LIBOR, and encouraged firms to be aware of the issues the transition poses and to allocate adequate resources to address issues as they arise.

The risk alert is available here.

SEC Staff Issues Risk Alert Regarding the Safeguarding of Customer Records and Information at Branch Offices

On April 26, 2023, the SEC's Division of Examinations issued a risk alert to remind registered broker-dealers and investment advisers of the importance of implementing policies and procedures to safeguard customer records and other information at branch offices. The "safeguards rule" of Regulation S-P requires registered broker-dealers and advisers to adopt written policies and procedures addressing administrative, technical and physical safeguards to protect customer records and information. These policies and procedures must be reasonably designed to keep customer records and information secure and confidential, protect against anticipated threats to the security or integrity of customer records and information, and protect against unauthorized access to or use of customer records and information that could result in substantial harm or inconvenience to customers. In the risk alert, the staff indicated that although many firms have implemented policies and procedures to meet these requirements at their main offices, some firms have not done so at branch offices, thereby exposing customers to risk.

In the risk alert, the staff noted the following observations relative to the implementation of the safeguards rule at firms' branch offices:

- The staff observed firms that failed to ensure that branch offices performed proper due diligence and oversight of vendors that provide services such as cybersecurity, technology operations and business applications. As a result, branch office systems and applications had weak or misconfigured security settings that exposed customer records and information to unauthorized access.

- The staff observed firms that did not manage e-mail accounts for branch offices and that had no policies and procedures to address branch office e-mail configurations, resulting in situations in which branch offices could obtain their own e-mail services from vendors without being subject to firm-imposed security requirements. The staff observed weak e-mail configurations at branch offices that led to accounts being compromised or that failed to capture all account activity, leading to poor incident response capabilities.

- The staff observed firms that did not consistently apply to their branch offices policies and procedures relative to data classification to identify where customer records and information should be stored electronically, resulting in failures to identify and control customer records and information.

- The staff observed firms that did not enforce controls requiring complex passwords and multi-factor

authentication for remote access to systems at branch offices, leading to security breaches.

- The staff observed branch offices with out-of-date systems as a result of the failure to apply firm policies and procedures on inventory management, patch management and vulnerability management. The staff also observed firms that were unaware of the systems running on the networks of their branch offices. As a result, branch offices were exposed to greater technology risk and more susceptible to system compromises.

The risk alert is available here.

Litigation and Enforcement Matters

SEC Brings First Liquidity Rule Enforcement Action

On May 5, 2023, the SEC announced its first enforcement actions under Rule 22e-4 under the Investment Company Act of 1940, the SEC's liquidity rule, specifically in the form of a lawsuit filed in federal court and a settled administrative proceeding—both of which stem from the same underlying violations of the rule by a registered mutual fund. These actions provide important insight into the SEC's commitment to enforcing new rules, and also send a broader message about board oversight responsibilities.

On May 22, 2023, attorneys in Vedder Price's Investment Services Group and Government Investigations and White Collar Defense Group published an article regarding this enforcement action. The article is available here.

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