

# ***FS Regulatory Brief***

## ***Advisers' key concerns on Form PF implementation***

November 2012

### ***Introduction***

The August 29, 2012 filing deadline for first-time Form PF (the "Form") filers has come and gone. Before the dust has even begun to settle, advisers are already compiling data and responses for the next filing deadline on November 29, 2012. With little time between filings, many of these early filers are leveraging their experiences from their first filing and in some cases evaluating various third-party and/or technology solutions to make the process less painful and time consuming. Those that have yet to file know that they have a demanding task ahead of them, but can learn what to expect and how to better manage this tedious process from their industry peers. Through its work with several first-time filers, PwC has identified key trends and issues that are valuable to all filers as the reporting requirement continues to phase in for registered private fund investment advisers.

### ***Manual processing vexes advisers***

To better understand Form PF implementation issues, PwC recently conducted a survey of private fund adviser clients. Their biggest concern (58% responded as such) was the manual nature of the process used to gather and report the information for Form PF. More than 60% of advisers responding to the survey stated that they are manually compiling data and are relying less on technology or third party solutions.

While advisers can expect the industry to develop more automated solutions over time, whether it's through the adviser's technology team or through an administrator or technology vendor, most first-time filers were in an unfortunate position — they had to work

through the tedious process of gathering granular pieces of data, tagging or enhancing that data in its systems or reports so that it is usable, calculating responses to questions on a spreadsheet, and then manually inputting those responses into the Form. As a result, the filing process was vulnerable to human error, and the staff of the various departments that were engaged to complete the Form were sometimes overwhelmed with the significant time burden of enriching and compiling the necessary data.

Whether an adviser plans to implement a more automated solution over time or continues to conduct the filing exercise manually, in our view, the adviser should develop a sound and controlled process that is repeatable and documented in some form of a regulatory filing procedure that can serve as a governance framework for regulatory filings. This framework should be described in a narrative form and illustrate the firm's regulatory filing accountability, responsibility, and ownership structure.

Integral to establishing this governance framework is designating an individual within the firm as the head of regulatory reporting. This individual should have a strong grasp of the technical accounting and operational functions unique to the adviser and should have sufficient authority to drive the Form PF process. The responsibilities of the head of regulatory reporting can also extend beyond Form PF and address other filings like Form CPO-PQR, Large Trader, upcoming AIMFD requirements, etc. Under the head of regulatory reporting should be designated individuals within each operational group (i.e., legal, operations, accounting, investor relations, risk, etc.) who are responsible for the data gathering exercise for his/her specific group.

Each responsible party should be trained in the specific questions they are responsible for answering, ensuring they understand the nuances of Form PF, the assumptions the adviser has made that may apply to their questions, and any SEC FAQs and/or industry trends. The integrity of the data being utilized should be considered by understanding the source of the data and the level of enrichment and manipulation required to get the data to a point where it is useful for Form PF purposes. Using this verified data, individuals responsible for calculating and responding to questions should submit their responses to the respective operational group heads. The group heads should then review the responses for accuracy and completeness, and then submit the final responses to the head of regulatory reporting for final review.

The adviser should periodically evaluate its staff demands and, if necessary because of the increased regulatory reporting burden, consider additional resources, and whether an operational/accounting background and/or a compliance background is the right fit for that role.

### *Open to interpretation*

Our survey indicated that first-time filers experienced multiple headaches due to the ambiguity of certain instructions and questions in the Form. Each adviser is unique and trying to figure out how the instructions and questions apply to each firm is not always clear. As a result, advisers have developed interpretations that may not always be consistent with other advisory firms in the industry.

For example, in PwC's survey, advisers had different interpretations around instruction 8 and its application to the "look through" of Special Purpose Vehicles ("SPVs"). For financial statement purposes, the SPV is typically reported on a net basis; however, instruction 8 appears to indicate that the SEC may want reporting at any level in the structure. Instruction 8 says the following: "You, (the filer) are not required to "look through" a fund's investments in any other

entity unless the Form specifically requests information regarding that entity or the other entity's primary purpose is to hold assets or incur leverage as part of the reporting fund's investment activities." Half of the respondents who had SPVs noted that they were looking through the SPV entity, considering borrowings at the SPV level in their analysis of whether the reporting fund is a hedge fund and providing SPV reporting consolidated with the reporting fund on both the assets and liabilities held in the SPV. The treatment of an SPV in this scenario can also create operational challenges in data collection as the filer's accounting systems may not be appropriately configured to download the necessary data in a convenient way.

Although differing views may exist, the filer should develop interpretations of the instructions and assess the impact of its decisions throughout the Form. Regardless of the interpretation, the adviser should consistently apply its approach throughout the Form, where possible.

### *How much is appropriate*

Another challenging aspect of the Form PF process is the development and disclosure of assumptions in question 4 of the Form. Depending on the complexity of the adviser and how it interprets certain aspects of the Form, the filer may develop a significant number of assumptions; however, it then has to determine which ones are appropriate to disclose in question 4. Without specific guidance on the subject, the industry has varied opinions on how many disclosed assumptions are appropriate. Based on the survey conducted by PwC, roughly 40% of respondents stated that they've included between 0 and 10 assumptions in response to question 4. Another third of respondents stated that they've included 21-30 assumptions, indicating variances in practice. Very few survey respondents stated that they included greater than 30 assumptions in their submitted Form PF.

Given the risk of inappropriately withholding pertinent information on the Form, the

adviser should engage its counsel for guidance on the matter. Further, the adviser should maintain in its books and records both assumptions that were included in the filing and those that were maintained internally.

### ***For investors' eyes?***

The information on an adviser's Form is filed with the SEC, which shares it with the Financial Stability Oversight Council. The information is not publicly available. Filers may have to evaluate whether to share the filing with current and prospective investors. About half of the respondents in PwC's survey stated that they did not plan on providing investors with their Form PF filing, while about a quarter said they would allow a review in their offices and the remaining quarter of respondents said that they are still evaluating how to address the matter. Whatever practice the adviser decides to implement, it should be cognizant of the potential conflicts arising around selective disclosures in providing transparency to only certain investors.

If investors do have access to the adviser's filing, the adviser may also want to be prepared to share its interpretations of the Form questions and its responses to certain questions in the Form, such as those around strategy or the correlation of portfolio liquidity and investor liquidity. Investors could perceive discrepancies between responses in the Form and what has been represented to investors in other investor deliverables.

### ***Who bears the cost?***

Filing Form PF has been an expensive process for many filers. Integrating the Form PF process into the adviser's business, utilizing counsel or other third parties to help assess the Form's impact, and/or engaging outside vendors or administrators to simplify the mechanics of filing can easily accumulate into a significant cost. Many in the industry have

questioned who should bear the cost of the Form PF process, the adviser or the funds.

In PwC's survey, a little over one-third of the respondents stated that none of the expenses generated from the Form PF exercise are being allocated to its funds. Other respondents noted that only certain expenses, i.e., administrator or consultants, will be borne by the funds, and still others remain undecided as to who should bear the cost.

Regardless of what the adviser believes is appropriate, it should review its fund offering documents to understand what it has disclosed to investors regarding allowable expenses, and if regulatory reporting of this nature could be an allowable fund expense. The adviser should also consider past practices around similar types of expenses, if applicable. In the event that the adviser elects to deviate from previous practices, it should be prepared to explain why.

### ***First time filers***

Those that will be making their first filing in 2013 may face a unique challenge given that they are likely to have a smaller capital base and infrastructure. Many of the aforementioned suggestions around establishing a controlled Form PF procedure may be difficult to implement with fewer staff and resources. First time filers should not underestimate the demand Form PF puts on staff and operational units across the firm. Advisers gearing up for their first filing should learn from the experiences of previous filers and be proactive by contemplating the issues and topics presented in this regulatory brief now. They should begin engaging counsel and consultants, if necessary, to understand the unique impact Form PF may have on their businesses so that they are prepared to undertake the Form PF exercise efficiently and effectively, and on an ongoing basis.

# Additional information

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