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SEC Rules and Regulations

SEC Staff Responds to Questions About Form PF

On June 8, 2012 and June 29, 2012, the Division of Investment Management of the Securities and Exchange Commission (the "**SEC**") issued responses (the "**Responses**") to frequently asked questions regarding Form PF. Investment advisers registered or required to register with the SEC under the Investment Advisers Act of 1940 (the "**Advisers Act**") that advise one or more private funds (*i.e.*, 3(c)(1) or 3(c)(7) funds) and that have at least $150 million in private fund assets under management ("**private fund advisers**") are required to file Form PF with the SEC for the purpose of reporting systemic risk information to the SEC. Additionally, private fund advisers that are also registered with the Commodity Futures Trading Commission (the "**CFTC**") as commodity pool operators ("**CPOs**") and commodity trading advisors ("**CTAs**") and are required to file Form PF under the Advisers Act must file Form PF with the SEC to satisfy certain CFTC filing requirements with respect to their commodity pools that are private funds. Such CPOs and CTAs may file Form PF with the SEC to satisfy certain CFTC filing requirements with respect to their commodity pools that are not private funds. Please see the ***November 18, 2011 Investment Management Regulatory Update*** for a discussion of the final Form PF rules and the ***June 19, 2012 Investment Management Regulatory Update*** for a discussion of the initial Form PF deadlines.

The Responses address a range of Form PF issues, including private fund categorization, the definition of a "hedge fund," the aggregation of parallel managed accounts advised by related persons, the reporting requirements applicable to disregarded private funds, the reporting of information on an adviser's relying advisers and SPVs that are related persons and certain question-specific issues.

A number of the Responses related to the definition of a "hedge fund" for purposes of reporting on Form PF. Form PF generally defines a "hedge fund" as any private fund that has the ability to pay or allocate a performance fee or allocation to its adviser(s), borrow in excess of a certain amount or sell securities or other assets short. In response to one question regarding this definition, the SEC clarified that a private fund that an adviser characterizes as a private equity fund may nonetheless be categorized as a hedge fund for purposes of Form PF reporting if the fund's documents allow the fund either to employ large amounts of leverage or sell assets short. The SEC noted that the definition of a hedge fund focuses on potential use, rather than actual or contemplated use, of leverage or short selling. In response to another question, the SEC confirmed that the categorization of a private fund as a hedge fund may vary from reporting period to reporting period. The SEC noted that, for any fiscal quarter, a private fund should be treated as a hedge fund if it met the definition of a hedge fund as of the last day of any month in the fiscal quarter immediately preceding the adviser's most recently completed fiscal quarter. Thus, an adviser with a December 31 fiscal year-end that advises a private fund with $1.6 billion in assets under management that did not meet the definition of a hedge fund until July 18 (due to, for example, a change to its fund documents allowing it to engage in short selling) would become a large hedge fund adviser subject to quarterly filing obligations beginning with its fiscal quarter ending December 31 because the private fund met the definition of a hedge fund on July 31 and the adviser had more than $1.5 billion in hedge fund assets under management on that date.

Another one of the Responses related to the categorization of a private fund that meets the definition of both a liquidity fund and a hedge fund. The SEC confirmed that an adviser to such a private fund must include such private fund in the calculation of liquidity fund assets under management and hedge fund assets under management and complete each section of Form PF applicable to liquidity funds and hedge funds.

Two Responses addressed issues relating to fund of funds. First, the SEC clarified that an adviser may treat as a disregarded private fund any private fund that (i) invests substantially all of its assets in the equity of private funds for which the filer acts as an adviser ("**internal funds**") and/or in the equity of private funds for which the filer does not act as an adviser ("**external funds**") and (ii) aside from such internal fund and external fund investments, holds only cash and cash equivalents and instruments acquired for purposes of hedging currency exposure. Such an adviser would only be required to complete section 1b for such disregarded private fund. Second, the SEC clarified that an adviser that only advises disregarded private funds or private funds whose investments may be disregarded under Instruction 7 must file a Form PF if the adviser and its related persons collectively have private fund assets under management that equal or exceed $150 million. However, disregarded private funds and disregarded investments need not be included when determining whether the filer meets the large private fund adviser thresholds or the $5 billion early filing thresholds discussed in the ***June 19, 2012 Investment Management Regulatory Update***.

The Responses also addressed question-specific issues. For example, one question related to Questions 28 and 78 of Form PF, which require large private fund advisers to provide a geographical breakdown of the investments held by the private funds they advise. The question considered in the Responses was how an adviser should treat a derivative in which the underlying asset is an equity security issued by a Canadian company that the private fund enters into with a French bank. The SEC clarified that an adviser has flexibility to determine how to report the geographical area of investments and that it should classify such investments in a manner consistent with the adviser's internal methodologies and the reporting of such information to investors. The SEC also noted that the adviser could explain its response in Question 4, which allows the adviser to discuss any assumptions that the adviser has used in responding to any Form PF questions.

- See a copy of the Responses

SEC Approves "Limit Up-Limit Down" Plan and Tighter Circuit Breakers

On May 31, 2012, the SEC approved two proposals submitted by the national securities exchanges and the Financial Industry Regulatory Authority ("**FINRA**") that are designed to dampen volatility in the stock market following the May 6, 2010 flash crash: the establishment of a "limit up-limit down" plan that would temporarily prevent trading in a particular listed stock in the event of rapid price swings, and the modification of existing market-wide circuit breakers. Both proposals are scheduled to go into effect on a one-year pilot basis on February 4, 2013. The SEC is seeking comments on the operation of the limit up-limit down plan and the new market-wide circuit breakers during the one-year pilot period.

Limit Up-Limit Down Plan

The new limit up-limit down plan, which is intended to replace the current single-stock circuit breakers, requires exchanges, alternative trading systems, broker-dealers and other trading centers to establish policies and procedures that prevent the execution of trades and the display of offers outside of a specified price band. Price bands for each security will be set (and reset throughout the trading day) at a percentage above and below the security's average price over the prior five minutes of trading, but they will not be reset if price movements within the period are one percent or less. If bid or offer quotations are at the far limit of the price band for more than 15 seconds, trading in that security will be subject to a five-minute trading pause.

Tightened Market-Wide Circuit Breakers

The market-wide circuit breakers (which, when triggered, halt trading in all exchange-listed securities throughout the U.S.) have been updated in a number of ways, including by:

- decreasing the existing 10%, 20% and 30% market decline thresholds that trigger market-wide trading halts to 7%, 13% and 20%, respectively;
- using the S&P 500 – not the Dow Jones Industrial Average – as the circuit breaker benchmark;
- recalculating the circuit breaker thresholds on a daily – not quarterly – basis;
- modifying the time when halts may be triggered; and
- modifying the length of halts to 15 minutes in the case of drops occurring at or before 3:25 p.m., except for when there is a 20% decline, in which case trading will be halted for the remainder of the day.

For further information, please see the June 6, 2012 Davis Polk Client Newsflash ***SEC Approves "Limit Up-Limit Down" Plan and Tighter Circuit Breakers***.

Industry Update

Treasury Modifies TIC Form D Instructions

The U.S. Department of Treasury (the "**Treasury**") recently revised the TIC Form D, a quarterly report that is designed to gather information on the levels of, and changes in, U.S. positions in cross-border holdings of derivatives contracts and the net settlement payments that arise from these contracts. The Treasury's revisions to the TIC Form D (i) clarify that the reporting requirements include foreign exchange swaps and cross currency interest rate contracts with foreign resident counterparties and (ii) accelerate the filing deadline to 50 days (instead of 60 days) following the last day of the fiscal quarter being reported. The first date to submit a quarterly TIC Form D on the revised report is August 20, 2012.

Required Reporting Entities. TIC Form D must be filed by a U.S. resident entity if (i) the total notional value of worldwide holdings of derivatives (including contracts with U.S. and foreign residents on a consolidated-worldwide basis) for the entity's own account and the accounts of its U.S. subsidiaries exceeds $400 billion at the end of the calendar quarter being reported or (ii) the amount reported by a TIC Form D reporting entity for "grand total net settlements" exceeds $400 million (where the amount is either a positive or negative value) in any quarter during the preceding two calendar years. Once a U.S. resident entity exceeds either threshold, the entity must file the TIC Form D for that calendar quarter, for the remaining quarters in the same calendar year, and for each quarter for the following calendar year.

Reportable Positions and Derivatives. The purpose of the report is to measure the fair value of cross-border holdings of derivatives contracts and the net settlement payments that arise from such contracts. A reporting entity must report the following cross-border derivatives positions on its TIC Form D: (i) its and its U.S. resident subsidiaries' positions with foreign residents and on foreign exchanges, plus, when serving as a broker, the entity's (or its U.S. resident subsidiaries') U.S. customers' positions on foreign exchanges and (ii) when the entity (or one of its U.S. resident subsidiaries) serves as a broker on behalf of foreign residents, including foreign resident subsidiaries of the entity, the positions of such foreign residents on U.S. exchanges (with such positions and net settlements being reported from the perspective of the U.S. exchange).

According to the TIC Form D's instructions, derivative contracts are reportable only if the contracts meet the FASB Statement No. 133 ("**FAS 133**") definition of a derivative contract. The instructions, however, set forth certain items that do not need to be reported on TIC Form D, including short sales of assets;

spot foreign exchange contracts; and commodities, securities or other non-cash assets received or delivered to settle derivatives contracts.

Reporting Requirements. The TIC Form D is required to be filed with the Federal Reserve Bank of New York (the "**FRBNY**"), acting as fiscal agent for the Treasury, not later than 50 calendar days following the last day of the calendar quarter being reported. A reporting entity must file one consolidated report for it and all of its U.S. resident subsidiaries on the same basis as annual reports are submitted to the SEC or on the same basis as described in generally accepted accounting principles. The reporting entity should generally be the top-tier U.S. resident entity in the organization.

Confidentiality. According to the TIC Form D's instructions, the information reported to the FRBNY is generally confidential and will not be publicly disclosed or published; however, such information may be disclosed to other federal agencies to the extent permitted by applicable law and aggregate data derived from the reports may be published or otherwise disclosed in a manner that does not specifically identify any individual reporting entity.

Penalties. The failure to file a timely and accurate TIC Form D can result in a civil penalty of between $2,500 and $25,000. A willful failure to file can result in criminal prosecution and a fine of up to $10,000 and, if an individual, imprisonment of up to one year, or both. Any officer, director, employee or agent who knowingly participates in such willful violation may be subject to a like fine, imprisonment, or both.

- See a copy of the TIC Form D instructions
- See a copy of the TIC Form D

NFA Proposes Rules to Simplify Reporting Requirements for CPO and CTA Members

On June 5, 2012, the National Futures Association (the "**NFA**") submitted to the CFTC proposed amendments to NFA Rule 2-46, which requires periodic reporting by registered CPOs on NFA Form PQR with respect to certain performance and other information for each pool operated by a registered CPO. According to the NFA, the proposed amendments would simplify the reporting requirements for registered CPOs and CTAs and avoid duplicate information from being reported on Form PF and CFTC Form CPO-PQR (for CPOs) and CFTC Form CTA-PR (for CTAs).

Under the proposed amendments, CPOs would generally satisfy their Rule 2-46 reporting requirements by filing the applicable schedules of CFTC Form CPO-PQR. However, because Schedule A of CFTC Form CPO-PQR does not include the schedule of investments in the current NFA Form PQR, the NFA would require that certain CPOs also complete a schedule of investments in order to satisfy their reporting requirements under Rule 2-46. Under the proposed amendments, a CPO would be required to report on the schedule of investments any investment that exceeds 5% of a pool's net asset value at the end of the reporting period. Currently, a CPO is only required to report an investment that exceeds 10% of a pool's net asset value.

Small CPOs (*i.e.*, CPOs with aggregate pool assets under management ("**AUM**") of less than $150 million) would be required to file Schedule A and a schedule of investments on a quarterly basis within 60 days of the quarters ending in March, June and September and on an annual basis within 90 days of the calendar year-end. Mid-size CPOs (*i.e.*, CPOs with AUM equal to or exceeding $150 million but less than $1.5 billion) would be required to file Schedule A and a schedule of investments on a quarterly basis within 60 days of the quarters ending in March, June and September, and Schedule A and Schedule B of Form CPO-PQR on an annual basis within 90 days of the calendar year-end. Large CPOs (*i.e.*, CPOs with AUM equal to or exceeding $1.5 billion) would be required to file Schedule A and Schedule B on a quarterly basis within 60 days of the end of each quarter. CPOs that are also registered with the SEC and file Form PF in lieu of Form CPO-PQR would be required to file Schedule A and a schedule of investments on a quarterly basis within 60 days of the end of each quarter, except for the quarter ending on December 31, for which the filing would be due within 90 days of the quarter-end.

The proposed amendments would also require registered CTAs to file NFA Form PR, which will generally consist of CFTC Form CTA-PR and certain additional information relating to the CTA's brokerage and other relationships, AUM for each trading program and monthly performance during the relevant quarter for each trading program. The filing would be made on a quarterly basis within 45 days of the quarters ending in March, June and September and on an annual basis within 45 days of the calendar year-end. While NFA Form PR would impose new requirements on CTAs, according to the NFA, the information required is "basic and straightforward and should not impose any significant burden on CTAs."

We will continue to monitor these developments.

- See a copy of the proposed amendments to Rule 2-46

CFTC Proposes Dodd-Frank Title VII Cross-Border Guidance and Exemptive Order

On June 29, 2012, the CFTC released proposed interpretive guidance regarding the cross-border impact of the swap-related provisions of Title VII of the Dodd-Frank Act. The CFTC also released a proposed exemptive order that would provide non-U.S. registered swap dealers and major swap participants with temporary conditional exemptions from many swap-related Title VII requirements for one year, and permit swap dealers and major swap participants that are U.S. persons to defer compliance with some requirements until January 2013. Comments on the proposed interpretive guidance are due 45 days after it is published in the Federal Register and comments on the proposed exemptive order are due 30 days after it is published in the Federal Register, which is expected shortly in both cases. For more information, see the July 3, 2012 Davis Polk Client Newsflash ***CFTC Proposes Cross-Border Guidance and Exemptive Order***.

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

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