ALERTS

SEC Updates Form PF Frequently Asked Questions

July 20, 2012

On July 19, 2012, the staff of the Division of Investment Management of the U.S. Securities and Exchange Commission (the "Staff") updated its Form PF Frequently Asked Questions (the "FAQs") to include significant new interpretive guidance on Form PF. The FAQs are available on the SEC's website at http://www.sec.gov/divisions/investment/pfrd/pfrdfaq.shtml.

The FAQs address a number of important questions. Of particular note, with respect to the reporting of counterparty credit exposure in Questions 22, 23, 36 and 37 of Form PF, the Staff clarified that advisers should only include counterparties for over-the-counter derivative transactions, loans and loan commitments. Advisers should not include assets held in custody at their custodians or prime brokers (except to the extent such assets are held as collateral by such custodians or prime brokers in their capacity as derivative counterparties or lenders), and advisers should not include futures positions or excess margin held at a futures commission merchant (Q.22.1).

The Staff also provided guidance on the definition of the term "borrowings," which it interpreted broadly to include certain types of synthetic borrowings (Questions 12 and 43 of Form PF). Specific examples of borrowings provided in the FAQs include short sales, securities lending transactions, repos, variation margin owed but not yet paid and certain types of synthetic borrowings (Q.12.1).

In light of the timing of these significant updates to the FAQs, the Staff has included guidance on whether advisers that have already set up systems to meet the initial Aug. 29 filing date are required to change their calculations for the initial filing to the extent the assumptions on which the answers in the initial filings are based differ from the guidance provided by the Staff. There is no extension to the deadline — advisers that meet the $5 billion threshold are still required to file on or before Aug. 29. However, the Staff has said that it will not recommend enforcement action if an adviser is unable to incorporate the Staff's guidance, so long as: (i) the adviser's assumptions were reasonable based on the facts and circumstances at the time its reporting system was developed, (ii) the assumptions or other approaches taken by the adviser in reporting information in its initial filing that are inconsistent with such guidance are identified in Question 4 of Form PF, and (iii) the adviser reflects such guidance in its Form PF reports filed after the initial filing (Q.A.3).

Other topics covered by the FAQs include:

- Adding deferred compensation as part of a fund's net asset value (Q.G.1)
- Using market value for derivatives (as opposed to gross notional value) in determining certain thresholds under Form PF (Q.11.1)
- Determining the amount to be reported as a borrowing for short sales (Q.12.2)
- Calculating a fund's counterparty credit exposure, including specific calculations for securities lending, short transactions, repos and derivative transactions (Q.22.1-Q.22.5)
- Requiring answers to Question 42 (the stress testing question), if a manager has models or other systems that have the ability to test the factors listed in Question 42 (Q.42.1)
- Determining the aggregate value of derivatives positions (Q.44.1)

Advisers that are required to file Form PF should review the latest updates to the FAQ and compare the Staff's guidance with the current assumptions on which the answers in their Form PF filings will be based.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

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