

FOCUS ON

FORM PF

Kristin Hoogerhyde, of Northern Trust Hedge Fund Services, explains the main aspects of Form PF requirements that managers should be addressing



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After several rounds of quarterly filings, completing Form PF has proven to be the complex and labour-intensive process many had predicted. Compiling data for submission presents logistical complications and the interpretation of the questions adds complexity that requires thoughtful planning. With new regulatory guidance and three filings of experience, this paper highlights key conversations fund managers should be having, and the ambiguities that make those conversations challenging.

NEW GUIDANCE AND NEW CONSIDERATIONS

On 8 March 2013, the Securities and Exchange Commission (SEC) released guidance with regard to several items throughout Form PF. The revised FAQ offered clarity and helped filing managers confirm the proper approach to many instructions and questions, some of which included: aggregating funds (FAQ H.1 & H.2); calculating derivative values (FAQ 44.2); calculating liquidity (FAQ 50.1).

However, in some instances, the new guidance represents a shift in expectations and will require filing managers to revise their approaches and processes. FAQ 24.2 is one such example.

Questions 24(b) and 24(c) look at trading and clearing mechanisms used for derivatives, noting that responses should be calculated on a volume basis. However, the new guidance instructs filers to instead answer this question on a values basis, and stipulates that values for derivatives should include:

- Delta adjusted notional values for options
- 10-year bond equivalents for interest rate derivatives

- Notional values for all other derivative positions

Capturing notional values at a transactional level does not present a significant issue. However, not all trading systems obtain the other metrics at the transactional level, and because delta adjusted notional calculations can vary widely within the course of a trading day, they should be captured at the point of trade execution to ensure precision. This could considerably increase the level of effort and cost required to complete the Form, and filers will need to recalibrate their approach to this question from both an operational and a methodological perspective.

Time will tell the implications of this new guidance, but it illustrates two key principles. First, Form PF's regulations are not set processes and will likely evolve over time. Second, because they could change, filers must build a level of adaptability into their processes and be prepared to re-evaluate as new guidance is introduced.

ADDRESSING THE INTERPRETATION OF QUESTIONS

While other SEC FAQs shed light on some of the Form's ambiguities, there remain several questions where the filer must interpret questions and be able to articulate the rationale behind their calculation methodology. Ultimately, these determinations fall to the filing manager's best judgement, and absent more clarification from the SEC or an agreed industry consensus, there is no "correct" approach.

Through our work with clients, we have identified numerous ambiguities throughout Form PF and we have outlined below a couple of examples along with the differing methodologies we have seen clients apply. In both cases, our intent is to offer insight into how others are approaching the questions, not to advocate for one practice over another.

DO "INVESTMENTS" INCLUDE CASH POSITIONS?

Often, the filing manager must define key terms within the questions, and more importantly, apply those definitions consistently. A prime example is the definition of "holdings" vs. "investments" in questions 20, 28, and 35.

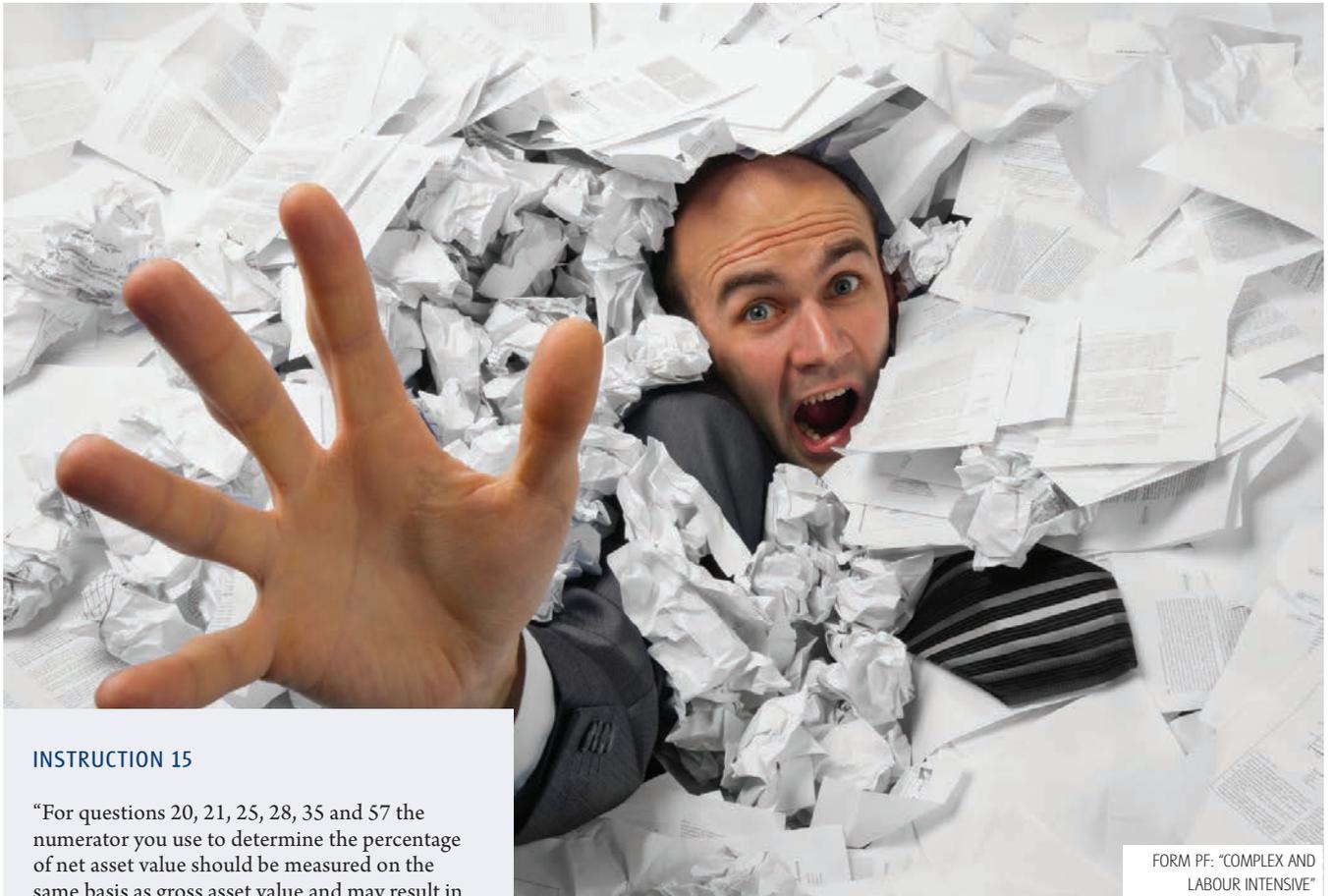
- Question 20 asks for a breakdown of "investment strategy" and Question 28 asks for a "breakdown of investments"
- Question 35 asks for a "position" breakdown and includes cash among the eligible sub-asset classes in the dropdown list.
- All of the questions fall under Instruction 15 (discussed next)

Many managers do not consider cash to be an investment position, suggesting that it be excluded from Questions 20 and 28 which ask for "investment" breakdowns. However, because cash is included in the sub-asset class dropdown in Question 35 and managers have attempted to apply Instruction 15, which envelops all three questions, consistently, it has led several managers to second-guess the treatment of cash in all three questions. These complexities all beg the question: do the words "investment" and "position" imply a difference in how the responses should be calculated?

Either interpretation can be effectively argued until the SEC provides clarification on how these should be interpreted. For now, filing managers must think through their treatment of these questions, reference their internal processes, and ensure that they have a sound rationale for their response.

“FORM PF HAS PROVEN TO BE THE COMPLEX AND LABOUR-INTENSIVE PROCESS MANY HAD PREDICTED. COMPILING DATA FOR SUBMISSION PRESENTS LOGISTICAL COMPLICATIONS AND THE INTERPRETATION OF THE QUESTIONS ADDS COMPLEXITY”

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FORM PF: "COMPLEX AND LABOUR INTENSIVE"

INSTRUCTION 15

“For questions 20, 21, 25, 28, 35 and 57 the numerator you use to determine the percentage of net asset value should be measured on the same basis as gross asset value and may result in responses that total more than 100%.”

CALCULATING GROSS ASSETS

Throughout the Form, complexity is added when instructions are layered on top of assumptions applied to individual questions. Initially, the interpretation of a bullet within Instruction 15, which defines the use of “gross assets” in certain questions, seems straightforward, but it factors into the “investments vs. positions” question described above and does not provide specifics around how the term “gross assets” should be calculated.

The industry view is that the SEC is requesting gross assets as a proxy for disclosing the amount of leverage within a reporting fund. If you accept this interpretation, the issue of whether cash counts as an investment position is compounded.

Take a hypothetical example of a balance sheet for a reporting fund:

- Assets: US\$8,000
- Liabilities: US\$4,000
- Equity (NAV): US\$4,000

The same fund has the following market values (MV) of investments as of the reporting date:

- MV of long investments: US\$5,000
- MV of short investments: US\$3,000

We have seen a broad range of approaches to interpreting this instruction, though two have emerged as the most common. Both examples assume the filing manager has excluded cash positions:

1. Absolute value of long and short investments – this approach brings the calculation closest to the gross

asset figure. Based on the example, a client using this approach would report Gross Assets/NAV as 200%.

2. Include assets (long investments) and exclude liabilities (short investments) – some filers choose to exclude liabilities instead of accounting for them on a net or absolute basis. Based on the example, a client using Approach 2 would report Gross Assets/NAV as 125%.

The result is that the interpretation of “gross assets” can result in a wide range of responses, placing the onus on managers to be able to define their approach, articulate the rationale for that approach, and apply it consistently across the responses in the Form.

CONCLUSION

These samples are not the only complexities of the Form, but they depict the major themes that managers should take into account. First, flexibility is important if filers are to adapt to new interpretations or requirements as they change over time. Second, filers must consider not only the interpretation of specific questions, but the relationships between questions and the instructions. Third, some interpretations are closely tied to how individual managers think about their portfolios.

Form PF will continue to evolve through a combination of pronouncements from the SEC, the incorporation of ideas from other regulatory reports (CPO-PQR, AIFMD, etc.), and as the industry reaches consensus around interpretation. Until then, being thoughtful about Form PF’s requirements and the intent of the questions is the best road to ensuring a consistent and compliant approach to filing. ■