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Form PF One Year Later:

How Hedge Funds Can Use Their Administrator to Effectively and Efficiently Assist them in Completing Form PF

Transaction Services

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As recently as five years ago, a hedge fund's administrator could be responsible for as little as calculating monthly NAVs and contributing some investor-relevant data for quarterly reporting. But following the financial crisis and demands from investors calling for greater liquidity and transparency into operations, running a hedge fund business has become more costly and complex. At the same time, many large firms have expanded through acquisitions and begun offering new fund structures and products, despite the compounding global regulatory requirements.

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As a result of these developments, funds are looking to outsource more back-and-middle office functions. Administrators are evolving beyond recordkeeping responsibilities, and funds are looking for strategic vendors to help them with the new regulatory reporting requirements, which in the case of Form PF have become a year-round exercise for a fund management company.

Second Round of Form PF

Large firms initially scrambled to complete their first Form PFs more than a year ago and sought peripheral help from administrators, mainly for data aggregation. Yet, they still managed the process in-house. Given that it was the first iteration of Form PF reporting, some firms drastically underestimated the time and resources it would take to complete the exercise. Now on their second round of filing, the firms have asked for more help up front.

While firms still want to keep their data close to the vest, administrators are getting inquiries from firms that are increasingly comfortable seeking a more formally unified solution. Given the amount of cooperation needed from the funds themselves and their investment manager, however, this process cannot, by definition, be completely outsourced.

As more firms with fewer assets are required to file Form PF, they are avoiding the mistakes of their larger-in-assets peers by allocating more time resources from the beginning of the process.

Feedback from some firms within the industry state that third-party specialist providers have not been helpful or are not yet in tune with what Form PF is ultimately asking for. While that may be true for some, an administrator is better positioned to assist in the filing given their access to a firm's trading, cash management and accounting data.

Five Steps for Using the Administrator

With the benefit of lessons learned from multiple filing cycles, and from the perspective of an administrator, the following points should be considered:

1. Establish An Internal Team

Even with an on-site team from the administrator helping to initiate the process, cooperation across the firm's support functions is necessary to successfully complete the filing. Before any schedules and completion targets are set, a firm should have at least one representative each from accounting, cash management, trading operations, technology, legal and compliance. All will have a role to play in the filing in some capacity and should be assigned ownership tasks.

Should a firm not have in-house employees serving these functions, it should do its best to gather all outsourced providers to work together on a regular basis. Once this team is in place, create a "responsibility matrix" and set up a weekly progress call and stick to it until a proper filing is made.

2. Establish Fund Manager Needs

Once the team is established, the administrator can help facilitate the workflow process with the manager. Before it can do so, it must establish what tools the fund manager needs. These include:

- The capability to store and deliver data in the required format and synchronize calculations
- Aggregation of data and mapping to each Form PF question
- An audit trail to track input and decisions from the Internal PF team that are used in each answer
- Step-by-step instructions for each phase of the process

For those firms filing for the first time, while the administrator can offer tips as to how other firms successfully completed a filing, the manager himself must decide the best way to conduct the process, including how much to lean on the administrator. Experience shows that some funds are outsourcing the process almost completely, preferring to allocate more internal resources elsewhere, while other funds seek more part-time involvement.

3. Allocate Resources, Set a Timetable of Deliverables

Having grossly underestimated how much time Form PF takes to complete during its first iteration, firms are now devoting time and resources up front and devising precise timelines. While daily updates might be too frequent, having a standing weekly call with the team to update progress is an essential part of meeting deadlines.

Now, it is common for some larger firms to either hire a full-time Form PF specialist to stay on top of the process year-round or for existing employees to completely shift their daily routines for three or more months.

4. Aggregate Data

While an administrator should have near real-time access to a client's own data, there is likely more cooperation needed with other third-party providers, prime brokers, data warehousing vendors and trading counterparties. With greater data availability, the data portion of the filing becomes the easiest to prepare for, build around and automate.

In the specific case of regulatory AUM ("RAUM"), arguably the most important data point in the entire form, the key to getting this number correct is consistency. There are a lot of ways to interpret the inputs for how RAUM is eventually calculated, and that should be determined by the fund's counsel, not its administrator.

In order to avoid a rejection of the form, RAUM must be consistent with the number on the firm's most recent Form ADV brochure. If new funds are added that would affect the calculation of RAUM, then Form PF requires that filers complete an amendment to Form ADV.

As back and middle office tracking technologies continue to improve, a fund's administrator should be able to provide seamless, browser-based access to the internal team. Furthermore, the administrator should be able to delineate who does and who does not have the privilege to access certain data depending on the sensitivity of the data and an employee's seniority. The data required for Form PF should be integrated into such a platform and mapped to the appropriate questions with oversight by all members of the team involved.

Another key to this particular process is determining portfolio and business risks that may not be incorporated in specific data points. This is why weekly meetings are important to discuss and assess holistic and qualitative risks.

5. Perform a Test Run

Once the data is aggregated and calculated, the administrator should then set up a test run with the client.

First, a web-based view of a draft version of the form that features drill down capabilities and audit data should be produced, and re-calculations made for ultimate sign-off. Once this is done, the administrator and the team should conduct a test run prior to the form's final submission. Assuming the team has been keeping an accurate audit trail of its work, it should be able to go back and correct any errors from the dry run with relative ease.

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While the SEC has been cooperative in collecting feedback from first-time filers and adjusting processes and interpretations accordingly, no firm wants to have a final form rejected, especially given the work involved. Running through the equivalent of a "dress rehearsal" to test the connectivity and XML validation should help to prevent this from happening.

Does Fund Size Matter when Seeking Assistance from an Administrator?

Funds of all sizes that are required to file the Form PF may want to consider using their administrator to help them complete it. Funds should also realize that just because the process is complete and the filing is accepted, the process is not "over" until next year. Once a firm exits one PF cycle, it immediately enters the next one. Also note that an administrator will never assume the responsibility for actually filing Form PF on behalf of the manager.

Who Pays for Form PF? Updating Your PPM

It is very realistic that older firms might not have updated their investor private placement memoranda ("PPM") since Form PF was mandated by Dodd-Frank. This is important because outdated PPMs may not be clear as to who pays for the expenses incurred by the manager in connection with Form PF.

It is ultimately up to a firm and its investor base to determine whether the cost of Form PF be included in the management fee and be paid out of the management company's general operating funds, or be billed directly to the fund itself. This detail might seem trivial at first glance, but given the substantial personnel and monetary costs involved in completing Form PF, it cannot be ignored.

Conclusion

In the last three years, Form PF has gone from a non-existent construct to arguably one of a hedge fund manager's most important filing requirements. Given that it is still in its embryonic phases, funds and third-party providers alike are all operating on the same learning curve. As administrators expand their services to include more consultatory capabilities, Form PF assistance should be at the top of their offerings.

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