

Strategic Guidance

FORM PF – A Guide To Creation, Calculations, And Reporting for RIAs

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In January 2011, the SEC proposed that Registered Investment Advisors file the FORM PF to assist with the agency's evaluation of systemic risk. When adopted, the FORM PF will create a new reporting paradigm for advisers. This strategic guidance reviews the FORM PF with an eye towards operations and reporting infrastructure enhancements.

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The Securities and Exchange Commission (SEC) recently enacted a rule that requires Registered Investment Advisors (RIAs) to register with the SEC by March 30, 2012. Pursuant with the registration and in accordance with Section 404 of the Dodd-Frank act, the SEC (& CFTC) proposed that RIAs submit detailed information via the Form PF. The current version of the FORM PF was proposed on January 25, 2011 and can be found at this location: <http://www.sec.gov/rules/proposed/2011/ia-3145.pdf> .

The purpose of the FORM PF is to gather information that can be used to evaluate systemic risk(s) to the US financial ecosystem. To this end, the SEC is requesting detailed information across a broad operational spectrum, including:

- Assets Under Management (AUM), Net Asset Value (NAV), Gross Asset Value (GAV), and changes in values quarterly and annually
- Exposure by asset class, strategy, geography, and counterparty
- Trading, settlement, and turnover of total positions
- Liquidity of securities, financing, and investors
- Risk measurements such as VaR and Stress Test results

Large RIAs with aggregated assets greater than \$1 billion AUM will file the FORM PF quarterly. Smaller advisors will file annually. A final version of the FORM PF has not been released and a deadline for the first filing has not been set. While still a work-in-progress, it is likely that market volatility and tail-risk as exhibited during the Flash Crash (May 2010) and early August 2011 will heighten the SEC's desire to collect the requested data.

Unlike the Form ADV, the FORM PF will not be public. However, funds should be very aware that many investors are planning to request copies of the FORM PF once the SEC mandates submission. In addition, in terms of accuracy, the SEC has noted that data on the FORM PF could be used for investigatory purposes.

PURPOSE OF THIS WHITEPAPER

The purpose of this whitepaper is to identify key aspects from an operational and technical perspective. It is not intended to serve as a legal interpretation on concepts and definitions within Dodd Frank and/or the FORM PF framework.

This whitepaper will cover:

- Information included in the Form PF and completion requirements
- Potential technical and operational issues
- Potential aggregation, classification, and data integrity issues

Summary of Form PF:

| Section | Who must complete? |
|---------|---|
| 1a | All RIAs |
| 1b | All RIAs – separate 1b for each private fund advised |
| 1c | All RIAs – separate 1c for each hedge fund advised |
| 2a | RIA > \$1B AUM (Aggregated) |
| 2b | RIA > \$1B AUM -separate 2b for each hedge fund advised |
| 3 | Liquidity Funds |

As highlighted above, the FORM PF has three sections. Completion requirements are based on an aggregated AUM and the number of hedge funds advised by the RIA. Each section applicable to RIAs and hedge funds is covered below. Additional details and a Form PF toolkit can be referenced on the Performance Thinking & Technologies website, <http://www.p-t-t.com>.

| Section | Completion Requirement | Key Questions |
|---------|---|---|
| 1a | All RIAs | Advisor name and related person(s)...[1] Total Regulatory AUM and Net AUM....[2] |
| 1b | All RIAs with a separate section 1b for each private fund advised | Gross Asset Value (GAV)....[7] NAV....[8] Total Borrow....[9] [9a] by US Fin institutions [9b] by non-US Fin institutions [9c] by non Fin institutions Name & dollar amount borrowed from top 5 creditors if borrow is greater than 5% of NAV...[10] Aggregate value of derivative positions...[11] Beneficial owners and ownership percentage of top 5 owners...[12a,b] Fiscal year end...[13] Changes by month, quarter, and year NAV change in dollars...[14a-q] Gross Performance.... [14a-q] Net Performance....[14a-q] |
| 1c | All RIAs with a separate section 1c for each hedge fund advised | Name of Reporting Fund and Private Fund ID....[15a,b] Investment Strategy per defined category and percentage of NAV during reporting period...[17] Percentage of NAV managed using algorithmic computer-driven trading...[18] Counterparty exposure to top five counterparties As a percentage of NAV...[19a-e] Exposure in USD...[20a-e] Trading & Settlement mechanism, including exchange vs bi-lateral trade and clearing for the following instrument types: Equity & Debt...[21a-f] Derivatives...[21g-r] Repos...[21s] |

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| Section | Completion Requirement | Key Questions |
|---------|--|--|
| 2a | All RIAs for aggregated AUM greater than \$1 Billion during any day of the reporting period. | <p>Monthly Valuation of Long and Short positions by asset class and sub-asset class (defined)....[23]</p> <ul style="list-style-type: none"> Equity Corp. Bonds Convertible Bonds Sovereign, Govt, and Munis Loans Repos ABS Credit Derivatives FX Derivatives Non-US FX Holdings Interest Rate Derivatives Commodity (Derivatives) Commodity (Physical) Other Derivatives Investment in internal/external private funds/RIC Cash & Cash Management investments <p>Turnover rate (as a percentage of NAV) for 1st, 2nd, and 3rd month...[24]</p> <p>Geographic breakdown of investments (per defined regions and sub-regions)....[25]</p> |
| 2b | All RIAs for aggregated AUM greater than \$1Billion with a separate section 2b for each hedge fund that is advised | <p>Name of fund and private fund ID....[26]</p> <p>Monthly Valuation of Long and Short positions by asset class and sub-asset class (defined)....[27]</p> <ul style="list-style-type: none"> Equity Corp. Bonds Convertible Bonds Sovereign, Govt, and Munis Loans Repos ABS Credit Derivatives FX Derivatives Non-US FX Holdings Interest Rate Derivatives Commodity (Derivatives) Commodity (Physical) Other Derivatives Investment in internal/external private funds/RIC Cash & Cash Management investments <p>Liquidity (as defined by % of portfolio capable of defined categories below)....[28]:</p> <ul style="list-style-type: none"> 1 day 2 – 7 days 8 – 30 days 31 – 90 days 91 – 180 days 181 – 364 days 365+ days <p>Dollar value of unencumbered cash...[29]</p> <p>Number of open positions by month...[30]</p> <p>Portfolio Concentration by month (on positions > 5% of NAV) as defined by asset class...[31]</p> <p>Collateral – posted to fund by counterparty – based on top 5 counterparties and summarized by collateral type...[32]</p> |

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Collateral – posted by fund to counterparty - based on top 5 counterparties and summarized by collateral type...[33]
Top 3 counterparties to which the fund has greatest credit exposure as a % of NAV...[34]

Value at Risk Analysis...[35], including:
Confidence interval...[i]
Time horizon...[ii]
Calculation method...[v]
VaR by month...[vii – ix]

Stress Tests utilized based on various market factors and asset classes...[36]

Financing Information by month and summarized based on defined categories...[37]

Unsecured Borrowing...[a-i to a-iii]
Secured Borrowing...[b-i to b-iii]

Aggregate value of derivatives and posted collateral by month...[q38]

Financing Liquidity...[39]

Aggregate borrow/financing available to reporting fund...[a]
Liquidity of financing by time period...[b] by categories:

1 day
2 – 7 days
8 – 30 days
31 – 90 days
91 – 180 days
181 – 364 days
365+ days

Investor Information

% of NAV in side-pocket arrangement...[40a]
% subject to suspension of investor withdrawal...[40b]

*Investor Liquidity as % of NAV locked for specified time periods...[41]

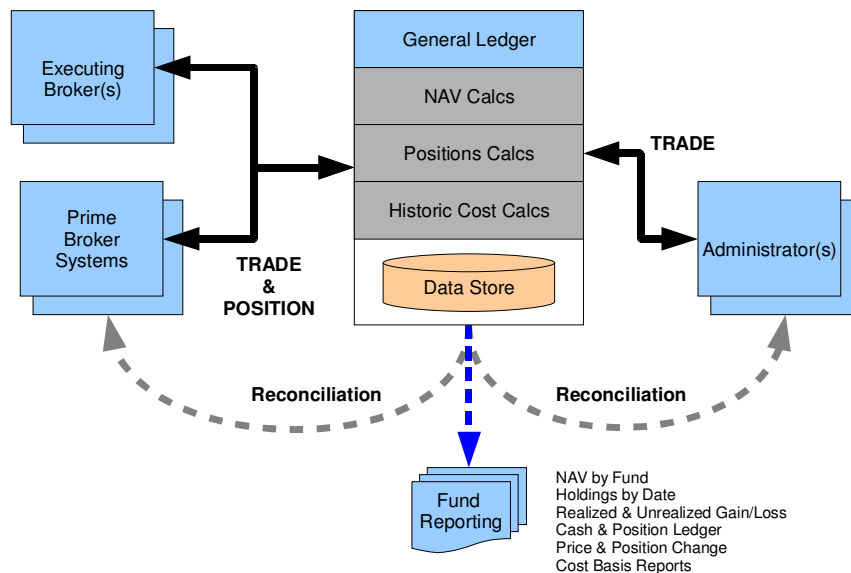
1 day
2 – 7 days
8 – 30 days
31 – 90 days
91 – 180 days
181 – 364 days
365+ days

OPERATIONAL AND TECHNICAL ISSUES RELATED TO FORM PF

Reporting requirements for the FORM PF “raise the bar” on regulatory reporting to a much higher standard than the previous Form 13F-HR standard. RIAs (and underlying hedge funds) will need to review the underlying data management and reporting capabilities to determine potential upgrades and systems needed to produce the FORM PF. As many of these changes involve ‘master data’ and aggregation of data across funds/feeder-funds, we advise clients to start this review as soon as possible.

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Chart1 – Standard Architecture of a General Ledger/Portfolio Management System



As the above diagram shows, a portfolio management system is designed as a general ledger system (G/L). The basis for G/L systems are cash-in/cash-out flows and the analysis of these cash flows on a point-in-time basis. G/L systems are good at reporting NAVs and changes in historic cost. These systems are not good at “classification” and aggregation of data across parent and child ‘master-feeder’ fund structures. **FORM PF reporting requirements rely on classification (security, financing, liquidity) and aggregation for a number of key questions.** We therefore anticipate that RIAs, at a minimum, will need to add additional classification to Portfolio Management Systems.

New Classifications/Master Data Management fields

Chart 2 shows potential classification and aggregation fields that are required to meet FORM PF requirements. This does not represent an exhaustive list of all fields that require either new classification or will require aggregated reporting.

Chart 2 – Master Data To Review for FORM PF

| Question | Field/Section | Description |
|--------------|------------------------------------|---|
| 4 | Regulatory Assets Under Management | Aggregation – includes assets held in parallel managed accounts |
| 7 | Gross Asset Value | Aggregation – master feeder or parallel managed account |
| 8 | Borrows | Classification – Classification by counterparty and sub-classification(s) by institution |
| 12 | Investor Concentration | Classification |
| 17 | Investment Strategies | Classification – Form PF defined strategies |
| 19, 20,32,33 | Counterparty Exposure | Aggregation & Classification – Aggregation across top 5 counterparties and classification by margin type |
| 21 | Trade & Settlement | Aggregation and Classification – Classification by Regulated vs Bi-lateral, sub-classification by security type |

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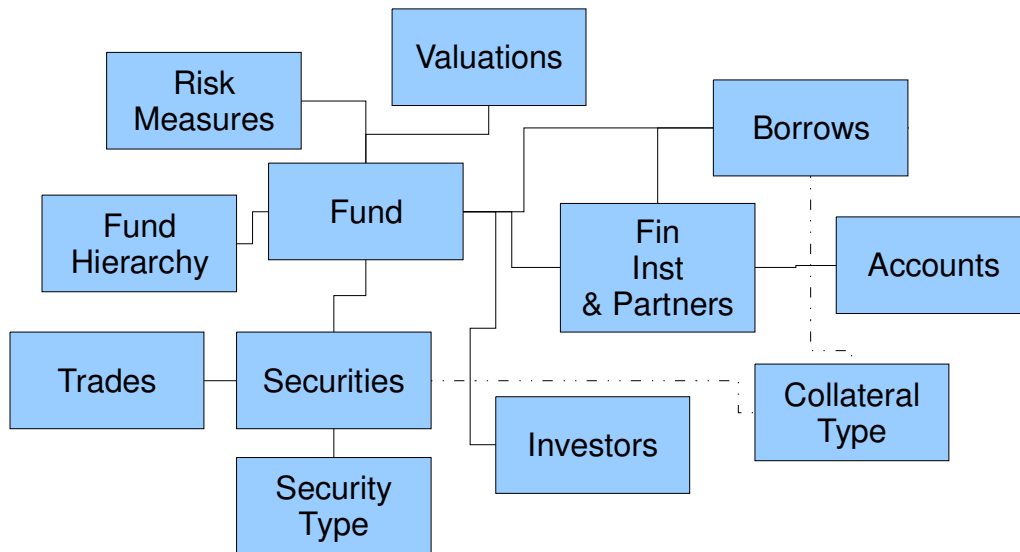
| Question | Field/Section | Description |
|----------|---|--|
| 23-25 | Section 2b – aggregated across all funds | Aggregation |
| 23,27 | Exposure by security type | Classification – Classification and sub-classification by security type |
| 25 | Geographic exposure | Classification – Classification and sub-classification by region |
| 28,39,41 | Liquidity (Security, Financing, Investor) | Classification by liquidation period |
| 37, 38 | Borrow Exposure | Aggregation & Classification – Classification by borrow type and sub-classification by institution and collateral type |

As the above table shows, the FORM PF involves much more than the ability to produce a NAV at a given point in time. Large funds greater than \$1Billion AUM and small funds should develop a plan and strategy to meet the FORM PF requirements.

A Simplified FORM PF Architecture.

In the next whitepaper, **FORM PF solutions**, PTT will identify solutions (both internal to an organization and external service providers) to complete FORM PF reporting requirements. These solutions will focus on the data architecture as pre-viewed below in Chart 3 Simple FORM PF Data Architecture.

Chart 3 – Simple Form PF Data Architecture



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About Performance Thinking & Technologies, Inc.

Performance Thinking & Technologies (PTT) focuses on operations, infrastructure, and risk management for alternative investments and the hedge fund industry.

As the past few years have shown, operational excellence is no longer an option. The ability to analyze operational risk, deliver institutional reporting needs, perform due diligence, and comply with new regulations is a core requirement for success.

So, let PTT help you maintain your investment focus. We'll help you build world-class operational capabilities. You focus on investment opportunities and generating return.

For more information about PTT, PTT operational toolkits, research, or FORM PF, please visit our website at <http://www.p-t-t.com> or email us at info@p-t-t.com.



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