Securities Regulation Daily Wrap Up, TOP STORY—Commission proposes enhanced Form PF reporting, expands Regulation ATS coverage, (Jan. 26, 2022)

Securities Regulation Daily Wrap Up

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Amendments to Form PF would require reporting within one day if an event signals risk to the broader financial system. Regulation ATS would cover Communications Protocol Systems.

The SEC has voted to propose amendments to enhance private fund reporting and, separately, to bring more Alternative Trading Systems under Regulation ATS. The proposed amendments to Form PF would require current reporting of certain stressors that could harm investors or create systemic risk. This, and other amendments, are intended to provide more timely and more useful data and enhance the FSOC's ability to assess systemic risk. Proposed amendments to Regulation ATS would expand the regulation's coverage to fully encompass ATSs that trade in government securities. Each proposal was approved by a 3-1 vote, with the opposition of Commissioner Peirce in each instance (*Amendments to Form PF to Require Current Reporting and Amend Reporting Requirements for Large Private Equity Advisers and Large Liquidity Fund Advisers*, Release No. IA-5950, and *Amendments to Exchange Act Rule 3b-16 Regarding the Definition of "Exchange"; Regulation ATS for ATSs That Trade U.S. Government Securities, NMS Stocks, and Other Securities; Regulation SCI for ATSs That Trade U.S. Treasury Securities and Agency Securities*, Release No. 34-94062, January 26, 2022).

Form PF. Adopted in 2011 and last amended in 2014, Form PF is used by certain registered investment advisers to report information regarding the private funds they manage. In this context, "private fund" includes hedge funds and private equity funds. Information obtained from Form PF filings provides the SEC and the Financial Stability Oversight Counsel (FSOC) with confidential insight into private funds' operations and strategies and helps to establish a baseline for use in assessing systemic risk.

The proposed amendments would apply to large hedge fund advisers, private equity advisers, and large liquidity fund advisers. According to the Commission, the changes would enhance FSOC's ability to monitor systemic risk, bolster the Commission's regulatory oversight of private fund advisers, and enhance investor protection efforts. SEC Chair Gary Gensler noted that over the last decade, the private fund industry has grown to a net asset value of $11 trillion while evolving in terms of business practices, complexity of structures, and investment strategies and exposures. Since 2011, the Commission has identified shortcomings and gaps in the data, and addressing these issues will allow the SEC and FSOC to receive more timely information about events that may signal distress at funds or market instability. The commissioners supporting the amendments also noted the market turmoil arising from COVID-19 in March 2020 and the social media-fueled volatility surrounding GameStop shares in January 2021.

The proposal would make three main changes to Form PF:

- Current reporting of certain events for large hedge fund advisers and advisers to private equity funds would be required. Currently, advisers are required to file Form PF on a quarterly or yearly basis, which, the commissioners noted, means that the information that may signal market instability can be stale by the time the Commission and FSOC receive it. The amendments would require reporting within one business day of events such as certain extraordinary investment losses, significant margin and counterparty default events, and events associated with withdrawals and redemptions.

- The reporting threshold for large private equity advisers would be decreased. The proposed amendments would reduce the threshold for reporting as a large private equity adviser from $2 billion to $1.5 billion in private equity fund assets under management.
- Reporting requirements for large private equity advisers and large liquidity fund advisers would be revised. Large liquidity fund advisers to report substantially the same information that money market funds would report on Form N-MFP, as proposed to be amended.

Comments will be due 30 days after publication in the *Federal Register*.

Peirce objects. Commissioner Peirce issued a statement detailing her "fundamental" objections to the proposed changes to Form PF, which she called "a fundamental shift in Form PF's scope and purpose." She noted that the adopting release makes clear that the use of Form PF information by the Commission for regulatory purposes is "ancillary to the underlying purpose of facilitating FSOC's monitoring for systemic risk." The enhanced reporting requirements seem intended to provide more information for the Commission's use. "A regulator's desire for data is insatiable, but more data is not always better," she said, urging instead that the Commission show what has been done with the information already required and whether it is insufficient to allow FSOC to monitor for systemic risk.

Peirce added that the requirement for "almost immediate reporting of localized events would distend Form PF into a tool for government to micromanage private fund risk management." The purpose of Form PF, she said, is to facilitate the FSOC's monitoring, not to inform the Commission about isolated trigger events affecting individual funds. Peirce also wondered what the FSOC and SEC would do with this information, Finally, she would support increasing the reporting threshold over decreasing it, as the amendments would do.

Regulation ATS. The Commission also re-proposed amendments to Regulation ATS that would include significant Treasury market platforms within the regulation's coverage. Amendments eliminating the Regulation ATS exemption for alternative trading systems trading U.S. government securities were first proposed in September 2020. The new proposal contains core elements of the 2020 proposal and incorporates feedback from the public, Gensler said.

First, the proposed amendments would expand Regulation ATS for alternative trading systems that trade government securities, NMS stock, and other securities. The proposed amendments would no longer exempt from Regulation ATS those ATSs that limit securities activities to government securities or repurchase agreements or reverse repurchase agreements on government securities and register as broker-dealers or are banks. The proposal would also require the ATSs to file additional public disclosures, depending on whether they trade government securities, NMS stock, or other types of securities. In addition, all ATSs subject to the Fair Access Rule would need to have written standards for granting, limiting, or denying access to their services. The proposal also expands Regulation SCI to government securities, applying it to ATSs that meet certain volume thresholds in U.S. Treasury Securities or Agency Securities.

Communication Protocol Systems. The proposed amendments would include Communication Protocol Systems within the definition of "exchange." These systems are a newer technology using protocols and non-firm trading interest to bring together buyers and sellers of securities but which do not fall within the current definition of exchange. As Commissioner Crenshaw observed, "fair competition requires entities performing similar functions to be regulated similarly," but these systems are not subject to SEC oversight or transparency requirements. To that end, "exchange" under Exchange Act Rule 3b-16 would include systems that offer the use of non-firm trading interest and communication protocols to bring together buyers and sellers of securities. Communication Protocol Systems that choose to operate as ATSs would then need to register as an exchange or operate under the ATS exemption, which includes registering as a broker-dealer, becoming a member of a Self-Regulatory Organization, and complying with Regulation ATS.

Peirce dissents. Commissioner Peirce was again the sole dissenting vote, believing that the proposal is "unwieldy." While agreeing that the market for government securities is in need of reform, she described the proposal as "too wide-ranging and, given its length, too unwieldy to facilitate careful consideration." Noting the 650-page length of the release, plus the 220 comment requests within, Peirce objected to the 30-day comment period, calling it "unconscionably reckless" to have such a short time to consider fundamental changes to the $22 trillion Treasury market; she would have voted for a proposal with a longer comment period.

Finally, Peirce warned anyone operating any service designed to facilitate any communication between buyers and sellers: "Read this release. Even if you have nothing to do with government securities or even fixed-income, or with traditional securities, read this release." The release covers a lot of ground, she explained, and "you should not assume that it has nothing to do with you, because it probably does."

The releases are Nos. IA-5950 and 34-94062.

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