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SEC Form PF:

The Burden of Business Progress

How wonderful that we have met with a paradox. Now we have some hope of making progress.

Niels Bohr - Physicist

<u>Introduction: Things are Never as Bad as They Seem</u>

Among the myriad of problems resulting from the global financial crisis was one that affected all market participants: financial institutions, banks, brokerage houses, exchanges, and investors. Regulators lost a firm footing on what had previously been confidence in the workings of the financial system itself. Thrown off what had previously been certainties, the analysis of what sequence of behaviors and events led to the crisis became, and continues to be, a top priority. Not to mix metaphors, but for a considerable period the intervention of central banks and governments effectively provided life support, preventing a complete collapse.

The impact of the crisis continues: Spain, Greece, Ireland and other countries face years of austerity. The real estate market, awash in debt, has not rebounded; the dollar is weak; unemployment remains high; growth low.

Faced with the facts of the crisis, legislators in the U.S. have responded with the Dodd-Frank Act. The Act itself represents a restructuring of some aspects of the financial industry, and seeks to assure greater consumer protection. The SEC is charged with an aggressive schedule for an across the board interpretation and implementation of the Act.

Owing to the fact that there was a systemic near-collapse, approaches to a prevention of a future event have focused on developing a system wide-solution. Of particular concern is risk, and so systematic risk has been seen as a key area for identification, definition, monitoring, measuring and tracking.

Insofar as hedge funds are concerned, there is the ongoing issue of registration. But with particular reference to systemic risk, and as part of Dodd Frank implementation, the SEC has proposed that fund advisers be required to report on a variety of categories for each fund via a new document, Form PF. The number of categories and frequency of reporting relates to the size of the fund. The data will be required on a by-fund and aggregate or company-wide basis.

That said, owing to what is seemingly nothing more than a regulatory burden, funds are about to generate and report a tremendous amount of data about themselves. To the extent that this data can be used to analyze the business, funds stand to leverage the information for growth. Thus, there is a paradox: regulatory burden becomes business progress.

Form PF: What's It All About?

In January 2011 the SEC issued the broad outlines of its proposed Form PF with an intended compliance date of December 15, 2011. A synopsis from the Commission is:

> Large private fund advisers would file Form PF on a quarterly basis and would provide more detailed information than smaller advisers. The focus of the reporting would depend on the type of private fund that the adviser manages:
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> Large hedge fund advisers would report on an aggregated basis information regarding exposures by asset class, geographical concentration and turnover. In addition, for each managed hedge fund having a net asset value of at least $500 million, these advisers would report certain information relating to that fund's investments, leverage, risk profile and liquidity.
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> Large liquidity fund advisers would provide information on the types of assets in each of their liquidity fund's portfolios, certain information relevant to the risk profile of the fund, and the extent to which the fund has a policy of complying with all or aspects of the Investment Company Act's principal rule concerning registered money market funds (Rule 2a-7).[1]

While this seems straightforward, the scope, breadth, and depth of the requested information is unprecedented and for the first time is holding rather than transaction based. This is a

[1] From the SEC Fact Sheet included in Jan 25, 2011 press release: http://www.sec.gov/news/press/2011/2011-23.htm

fundamentally different measure than is typically used or available. And it will be required every quarter.

A brief canvass of the information requested in the 44 page “form”, divided into four sections, shows that many funds simply will not be ready.

All registered fund advisers will be required to compete part one. As an example of the requirements, it includes aggregate detail for each fund such as: percentage of borrowing from U.S. vs. Non-U.S. Financial Institutions vs. Credit from Non-Financial Institutions; aggregate value of all derivative positions; trend and time sensitive data such as monthly NAV change and Performance (with and without fees and charges); strategy divided as a percent of NAV; exposure as a percent of NAV; securities types, clearing, and trading of derivatives.

Sections 2-4 apply to larger funds. Here, extensive details on asset class will be required. Importantly, the turnover rate for the portfolio in aggregate for each month of the reporting period will be required. Geographic information, exposure, and percent of portfolio capable of liquidation (from 1 day to one year) is also included. Financing, investor information, operational concerns and liquidity are all covered.

These are examples of the type of data being mandated, and are not the full comprehensive list of items.

It can seem, and will be daunting, unless firms take the opportunity now to think through viable solutions - because even in an emended version, it is unlikely that the requirements will be drastically scaled back.

While data has increasingly become a key driver for fund managers, it has largely been seen as part of the cost burden of the firm, designed to fulfill regulatory requirements or to generate standard reporting.

But data in and of itself needs to be structured even before it is interpreted for regulatory, operational, or business purposes. Here, imagine a situation where data sets, regardless of source can be “translated” and “talk” to each other in any combination necessary for a manager. Suppose for example, one turned the prism of Form PF and had all that information available not solely to assure regulators that there was not undue risk, but as a mechanism for understanding the position of the firm and as a basis for developing strategies and ideas for further growth on a by-fund basis?

The paradoxical effect of the regulation is that it will force firms to look at their business in a new way. Seen as a means of business control and growth, Form PF is the kind of analysis a firm may want to have even in the absence of an affirmative mandate to have it.

Here Comes Help: MIK and New Thinking on Data

MIK Fund Solutions has a simple goal: to marry data, and data sets, regardless of source, to the investment thesis. In the case of Form PF, much of the data is already resident in a firm. But it is so disparate as to be almost meaningless in terms of availability and having it in a manner acceptable for Form PF.

MIK has, over its history, consistently taken an approach that allows managers to drive data rather than having data be constrained to a certain limited scope. In the case of Form PF, much of what is required is currently available, and the remainder can be readily built and deployed.

The reason, however, is because MIK believes that data in whatever form managers require is essential as they run their business. Even in the case of a long-short equity funds, managers believe their approaches can be differentiated. Data properly delivered, both informs and confirms decisions.

So perhaps funds can welcome the paradox of Form PF and be ready not only to “check the PF box” but take a deep data dive and with hard numbers work to understand what they are doing, and what they can keep, change, or jettison as they seek to build alpha.

Progress is never a burden…even when birthed in paradox.