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FINANCIAL TECHNOLOGIES FORUM

Form PF Forces the Data Management Issue

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By Rebecca Baldridge

Following the passage of Dodd-Frank in 2010, investment advisers face a multitude of new challenges connected with SEC registration and reporting requirements. For many advisers, the extensive demands for a variety of new information add to the headaches involved in compliance.

While the new reporting requirements impose costly and complex burdens on hedge fund and private equity advisers, industry observers tend to agree that there is an upside to the vast changes mandated by the new regulations. The maintenance and harmonization of data across the industry have the potential to improve funds' abilities to better monitor and manage risk.

But getting there will involve major operational data management challenges, which are hitting home with the SEC-required Form PF (for private funds). In general, the emergence of Form PF is uncovering a lack of information technology infrastructure and internal processes to tackle the burden of gathering and aggregating the right data and filing efficiently with the SEC, say several industry sources.

Under the Form PF registration requirements, advisers and hedge funds are adjusting to significantly more extensive reporting requirements in terms of leverage, investment positions, trading practices, valuation policies, portfolio composition, investor base, side letter arrangements and more.

This leads to an onerous and data-intensive filing process for Form PF that requires advisers to gather, aggregate, harmonize and present data from a multiplicity of sources. For Form PF, much of the data required is stored with such service providers as hedge fund administrators, law firms and prime brokers.

"Data gets siloed according to type and use," explains Brian Sentance, CEO of Xenomorph, a provider of analytics and data management solutions. To compensate, firms have to create an infrastructure with easy access to positions, the entities with whom the positions are held, market data, valuations and more, Sentance says. Firms will likely have to streamline and possibly unify their data-gathering systems.

Hit hard are medium-sized funds with assets in the range of $150 million to $1 billion. Such funds typically have smaller operations and a relatively lean staffing structure. They in particular can experience considerable pressure on their core businesses as they struggle to meet new requirements, says Jeff Rhodenizer, account manager at Admiral Administration, a fund administrator that also offers Form PF services.

However, the most significant question facing all affected advisers is whether to invest more into IT infrastructure or outsource data management to a service provider.

Data management demands can vary greatly, depending on fund size, type, structure, strategy and other considerations. "Many advisers have multiple funds, multiple administrators, and data is all over the place," Rhodenizer says. "Putting a system in place is a large and ongoing project. The adviser must be diligent about creating a repeatable and transparent process that can be applied filing after filing."

With the extensive range of data sources and a history of maintaining data in disparate locations, many advisers, particularly those who don't want to invest heavily in IT infrastructure, are moving toward cloud computing for storage. Off-site data storage can have many benefits, including greater security and more robust disaster recovery capabilities. For in-house storage, a number of firms in the industry have already turned to vendors for data warehouse solutions. However, advisers are increasingly realizing that they need capabilities to meet downstream functional needs as well.

Consequently, many vendors – among them Advent Software, Advise Technologies and DataArt — offer Form PF services that function as overlays to their own warehousing or proprietary data management solutions.

Lyn Marcrum, a senior analyst with market research firm Aite Group, says that "the most useful solutions include work flow capabilities to complete and approve the form, as well as the ability to drill down from the aggregated levels required by Form PF to the individual fund level."

Hedge fund professionals such as Bill Christian, chief operating officer of GoldenTree Asset Management, laud flexible data-warehousing solutions that make it possible to automate the Form PF filing process. "Given the fact that we started with a little less than $1 billion and now we're almost at $18 billion, we need to have that level of flexibility. … The ability to store information, report on information, and answer clients', as well as regulatory, questions is key."

Managing and processing vast and disparate amounts of data aren't the only challenge advisers face.

Firms may find it difficult to interpret new regulations for data requirements and Form PF demands that a number of metrics be calculated using methods that are not typical for the industry.

For example, rather than reporting assets under management on a net asset value basis, advisers must now report regulatory AUM, which is calculated differently and strips out all leverage and liabilities to show an accurate level of assets.

Form PF also requires that advisers report Value at Risk statistical measurements of market volatility and perform stress testing, neither of which is universal among advisers. Moreover, it can be difficult to understand what the SEC wants in many cases and frequently asked questions documents published by the regulator may not provide sufficient clarification.

Hedge funds will also be facing greater scrutiny through the SEC's National Exam Program, as new Form ADV for adviser registrants (and, accordingly, new Form PF filers) may have to undergo presence exams. This would include on-site visits by regulators with a follow-up analysis several weeks later.

"The SEC wants to see firms that are new to the process and help them lay the groundwork for good risk management," says Aite's Marcrum. Others in the industry see the process as less useful, viewing it as a "light touch" exam that would only be able to identify the most egregious cases of fraud.

The implications of these new reporting requirements are multifaceted. With advisers and hedge funds forced to ensure consistency in data reporting across all formats — including the ADV and PF forms, client reporting and marketing materials — the imposition of one universal standard for data reporting across the industry likely will increase transparency and comparability, which would contribute to the fund selection process for investors.

Form PF is publicly available on the SEC website, and once investors see what type of information the SEC is requesting, they may be eager to gain access to this data themselves, particularly when it comes to performance and risk. Although funds may be hesitant to provide certain types of information due to concerns regarding confidentiality, some industry professionals, such as Janaya Moscony, president of SEC3 Compliance Consultants, say that these disclosures may ultimately benefit funds.

"As it becomes more difficult to launch funds in an environment where operating costs are increasing, smaller funds are likely to be at a disadvantage," counters Jeanette Turner, managing director and general counsel for Advise Technologies. Overall, though, the new requirements are creating a litmus test of sorts for the survival of the fittest. The hope is that systematized data management and reporting requirements will reduce the threat of human error and lead to reliable and repeatable processes, and consistent data.

"Funds will have better control and more checks and balances in place," Moscony says. "This information may help funds find new investors, and investors may get comfortable more quickly during the evaluation process. With fund operations becoming more robust, both advisers and investors might see a positive impact on the industry."