# The Private Fund Industry Five Years After the Dodd-Frank Act – A Survey Study

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ABSTRACT

This study evaluates the long-term implications of the unprecedented yet evolving post Dodd-Frank Act regulatory framework pertaining to the private fund industry. The Author collected and coded data for a population of 1267 registered investment advisers. Respondents (N=69) answered questions in several categories designed to identify cost, compliance, and management issues associated with the post Dodd-Frank Act regulatory framework. The findings in this study suggest that the industry is mostly affected by the uncertainty and higher costs associated with the Act, but under multiple metrics the industry appears to be coping well overall with the evolving post Dodd-Frank Act regulatory landscape.

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## I. Introduction

To assess the risks and opportunities associated with the evolution of the post-Dodd-Frank regulatory framework pertaining to private funds, this article evaluates the long-term implications of enhanced post-Dodd-Frank regulatory oversight of the private fund industry by way of a survey study. The Author collected and coded data to evaluate the long-term implications of Title IV of the Dodd Frank Act. The population for this study consisted of 1267 private fund advisers who registered before the SEC's registration effective date for private funds, March 30, 2012. The Author contacted the population via e-mail surveys. Respondents (N=69) answered questions in several categories designed to identify the long-term effects of Title IV.

The long-term implications of the fundamental reshaping of the regulatory landscape for the private fund industry through Title IV of the Dodd-Frank Act, entitled the Private Fund Investment Advisers Registration Act of 2010 (PFIARA or Title IV),[1] and the Jumpstart Our Business Startups Act ("JOBS Act"),[2] are largely unclear. While evidence exists in prior studies that the industry adapted well to the new regulatory environment in the aftermath of the Dodd-Frank Act,[3] the long-term impact of the new regulatory framework could be much broader than otherwise anticipated. In the aftermath of Title IV and the JOBS Act,[4] the SEC continues to

[1] Dodd-Frank Wall Street Reform and Consumer Protection (Dodd-Frank Act), Pub. L. No. 111-203, §§ 401-416, 124 Stat. 1376, 1571 (2010) (codified as amended at 15 U.S.C. § 80b-3, 15 U.S.C. § 80b-2).
[2] Jumpstart Our Business Startups Act, Pub. L. No. 112-106, § 201(a)(1), 126 Stat. 306, 313-14 (2012).
[3] Wulf A. Kaal, *Hedge Fund Manager Registration Under the Dodd-Frank Act*, 50 SAN DIEGO L. REV. 243 (2013); CITI PRIME FINANCE, HEDGE FUND BUSINESS EXPENSE SURVEY: INDUSTRY-WIDE BENCHMARKS FOR MANAGING A HEDGE FUND ORGANIZATION (2012), http://goo.gl/SO2iDe; KPMG, ALTERNATIVE INVESTMENT MANAGEMENT ASSOCIATION & MANAGED FUNDS ASSOCIATION, THE COST OF COMPLIANCE: 2013 KPMG/AIMA/MFA GLOBAL HEDGE FUND SURVEY (2013), https://goo.gl/MB1PPE; EISNERAMPER & HOFSTRA UNIV. FRANK G. ZARB SCH. OF BUS., DODD-FRANK BILL—A YEAR AND A HALF LATER: VIEWS FROM THE HEDGE FUND INDUSTRY 2–3 (2012), http://www.eisneramper.com/uploadedFiles/Resource_Center/Articles/Articles/Dodd_Frank.pdf [hereinafter EISNERAMPER SURVEY]; Press Release, Hofstra Univ., Dodd-Frank Drives Investor Acceptance of Hedge Fund Model, New Survey Reports (Apr. 12, 2012), http://www.hofstra.edu/home/news/pressreleases/archive/041212_doddfrank.html ("[M]ost hedge funds surveyed expect their operational cost will rise due to increased costs of the regulations found in the Dodd-Frank bill.").
[4] Jumpstart Our Business Startups Act, § 201(a)(1).

amend rules and SEC reporting forms that apply to the private fund industry.[5] While the SEC's adaptation of the regulatory framework for private funds can support the industry in its efforts to comply with the revised standards, by clarifying and optimizing the existing legal framework, it can also create uncertainty and higher costs for the industry.

The fundamental reshaping of the regulatory landscape for the private fund industry through Title IV, the JOBS Act, and the SEC's continuing development of the regulatory framework are the product and culmination of over seventy years of tension between the industry and regulators. Since the inception of private funds in the late 1940s, the private fund industry and regulators have debated the appropriate level of regulatory supervision for the private fund industry.[6] The private fund industry mostly opposed the registration of hedge fund managers and increased disclosure,[7]

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[5] See Money Market Fund Reform, Amendments to Form PF, Investment Company Release No. 311166, 79 Fed. Reg. 47,735, 47,863 (Aug. 14, 2014) (codified as amended at 17 C.F.R. pts. 230, 239, 270, 274 & 279); *Form PF Frequently Asked Questions,* US SEC. & EXCH.COMM'N, http://www.sec.gov/divisions/investment/pfrd/pfrdfaq.shtm1 (last visited Jan. 1, 2016).

[6] For some early discussion of the regulatory issues regarding hedge funds, see SEC Commissioner Hugh F. Owens' speech following the 1969 crash. *See* Hugh F. Owens, Comm'r, U.S. Sec. & Exch. Comm'n, A Regulator Looks At Some Unregulated Investment Companies: The Exotic Funds (Oct. 21, 1969), https://www.sec.gov/news/speech/1969/102169owens.pdf ("After all, the Commission is by law the guardian of the market place and is, consequently, responsible for supplying the protections of the securities laws to persons who invest in an entity which itself invests in securities. Suffice it to say, therefore, that the Commission is taking a long and hard look at such investing vehicles in this light."). There were also robust academic debate about how to regulate hedge funds. *See* Robert C. Hacker & Ronald D. Rotunda, *SEC Registration of Private Investment Partnerships After* Abrahamson v. Fleschner, 78 COLUM. L. REV. 1471, 1489 (1978) ("Clearly, a hedge fund is more analogous to a joint venture among experienced investors than to the usual client-adviser relationship in which the adviser possesses not only mixed motives but far superior experience and business understanding. SEC interference with the former is likely to be, at best, meaningless for investors and, at worst, fatal for hedge funds."); Note, *United States Securities Regulation of Offshore Mutual Funds*, 83 HARV. L. REV. 426, 440 (1969) ("The proliferation of hedge funds may cause the Commission to reconsider its position. In similar circumstances, West Germany has felt a need to circumscribe the short-selling activities of offshore funds.").

[7] U.S. SEC. & EXCH. COMM'N, STAFF REPORT: IMPLICATIONS OF THE GROWTH OF HEDGE FUNDS 90 (2003) [hereinafter 2003 SEC HEDGE FUND REPORT], http://www.sec.gov/news/studies/hedgefunds0903.pdf; Stephen Brown et al.,

arguing that private funds' ability to invest in global markets without supervision and significant disclosure obligations helped generate higher returns, attracted investors to the industry, and facilitated its significant growth. The industry argued that regulatory oversight could be an infringement on hedge fund managers' ability to generate absolute returns.[8] Because private fund advisers traditionally sold units to accredited investors and operated on a relatively small scale at the inception of the industry, regulators initially granted broad exceptions and safe harbors that facilitated the industries' evolution as unsupervised entities, free of most regulatory supervision.[9] While prominent scholars pointed out that hedge funds were not to blame for the financial crisis,[10]

*Mandatory Disclosure and Operational Risk: Evidence from Hedge Fund Registration*, 63 J. FIN. 2785, 2789 (2008); MANAGED FUNDS ASS'N, WHITE PAPER ON REGISTRATION OF HEDGE FUND ADVISERS UNDER THE INVESTMENT ADVISERS ACT OF 1940 (July 7, 2003), https://www.sec.gov/spotlight/hedgefunds/hedge-mfa2.htm#wpaper1("We do not believe, however, that mandatory registration of all hedge fund managers under the Investment Advisers Act of 1940 is merited. Sophisticated investors that today invest in hedge funds are able to evaluate the merits of investments in such funds and therefore do not need the additional protection that registration would provide"); Carol J. Loomis, *Hard Times Come to the Hedge Funds*, FORTUNE, Jan. 1970, at 100, 100 (stating that the threat of SEC action was viewed as a deterrent to growth, and hedge fund managers in the 1960s and 1970s disliked the thought of SEC regulation, dreading the "prospect of an SEC move that would prevent them from earning their compensation in the traditional way"); *Hedge Fund Operations: Hearing Before the H. Comm. on Banking & Fin. Servs.*, 105th Cong. 26 (1998) (statement of Alan Greenspan, Chairman, Fed. Reserve Bd.) (repeating Greenspan's support for continued loose regulation of the hedge fund industry).

[8] *See* Michael R. King & Philipp Maier, *Hedge Funds and Financial Stability: Regulating Prime Brokers Will Mitigate Systemic Risks*, 6 J. FIN. STABILITY 283, 284, 293 (2009) (arguing against increased regulation of hedge funds); Hossein Nabilou & Alessio M. Pacces, *The Hedge Fund Regulation Dilemma: Direct vs. Indirect Regulation*, 6 WM. & MARY BUS. L. REV. 183, 235 (2015) ("[D]irect regulation of hedge funds would impose compliance costs that may discourage the hedge fund business altogether").

[9] Wulf A. Kaal, *Hedge Fund Regulation via Basel III*, 44 VAND. J. TRANSNAT'L LAW 389, 412–16 (2011) [hereinafter Kaal, Basel III] (summarizing hedge fund regulation before the Dodd-Frank Act).

[10] Andrew W. Lo, *Regulatory Reform in the Wake of the Financial Crisis of 2007-2008*, 1 J. FIN. ECON. POL'Y 4, 16 (2009) ("While the shadow banking system has no doubt contributed to systemic risk in the financial industry, hedge funds have played only a minor role in the current financial crisis, as evidenced by the lack of attention they have received in the government's recent bailout efforts."); Roberta Romano, *Against Financial Regulation Harmonization: A*

politicians and policy makers relied on other studies suggesting a destabilizing effect of private funds on financial markets[11] to demand greater regulatory scrutiny of the private fund industry.[12]

*Comment* 3 (Yale Law & Econ., Research Paper No. 414, 2010), http://papers.ssrn.com/sol3/papers.cfm?Abstract_id=1697348 ("[T]here is an absence of evidence pointing to hedge funds as a contributing factor in the recent financial panic."); Stephen Brown et al., *Hedge Funds After Dodd-Frank*, NYU STERN SCH. BUS. (July 19, 2010, 3:41 PM), http://w4.stern.nyu.edu/blogs/regulatingwallstreet/2010/07/hedge-funds-after-doddfrank.html (assessing hedge funds' noncontribution to systemic risk in general and during the recent crisis); LLOYD DIXON ET AL., HEDGE FUNDS AND SYSTEMIC RISK xv (2012) ("Our assessment is that hedge funds were not a primary cause of the financial crisis, although some aspects of their operations contributed to the crisis.").

[11] *See, e.g.*, Cecilia C. Lee, *Reframing Complexity: Hedge Fund Policy Paradigm for the Way Forward*, 9 BROOK. J. CORP. FIN. & COM. L. 478, 503 (2015) (discussing the systemic risk posed by hedge funds via the shadow banking system); Hedge Funds and the Financial Market: Hearing Before the H. Comm. on Oversight and Gov't. Reform, 110th Cong. 27, 36 (2008) (prepared statement of Andrew W. Lo, Professor, MIT Sloan School of Management) ("[O]ver the past decade, these investors and funds have become central to the global financial system, providing loans, liquidity, insurance, risk-sharing, and other importan[t] services that used to be the exclusive domain of banks. But unlike banks—which are highly regulated entities (but less so, since the repeal of the Glass Steagall Act in 1999), with specific capital adequacy requirements and leverage and risk constraints—hedge funds and their investors are relatively unconstrained. . . . [Hedge funds] can also cause market dislocation in crowded markets with participants that are not fully aware of or prepared for the crowdedness of their investments."); Tobias Adrian et al., *Hedge Fund Tail Risk*, *in* QUANTIFYING SYSTEMIC RISK 155, 155 (Joseph G. Haubrich & Andrew W. Lo eds., 2013) ("While hedge funds are liquidity providers in usual times, during times of market crisis, they can be forced to deliver, potentially contributing to market volatility."); Photis Lysandrou, *The Primacy of Hedge Funds in the Subprime Crisis*, 34 J. POST KEYNESIAN ECON. 225, 227 (2011) ("Take away hedge funds and a general financial crisis could still have occurred in 2007–8, but it is only because of the hedge funds that the crisis that actually occurred initially took on the . . . form of a subprime crisis."); John Kambhu et al., *Hedge Funds, Financial Intermediation, and Systemic Risk* 11–12 (Fed. Reserve Bank of N.Y., Staff Report No. 291, 2007), http://papers.ssrn.com/sol3/papers.cfm?Abstract_id=1003210 ("If systemic risk is fundamentally about financial markets linkages to the real economy, then hedge funds create systemic risk to the extent that they can disrupt the ability of financial intermediaries or financial markets to efficiently provide credit. . . . [B]anks' direct exposure to hedge funds has been growing proportionately with the hedge fund industry itself.").

[12] A summary of congressional action following the financial crisis on hedge funds is provided by the Congressional Research Service. *See* KATHLEEN ANN

Seizing on the increasing political pressure during and after the financial crisis of 2008-09, the U.S. Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act or Dodd-Frank).

This Article demonstrates that the private fund industry is adjusting well to the evolving regulatory landscape pertaining to it. The long-term impact of the evolving post Dodd-Frank Act regulatory landscape appears to be much less intense than the industry initially anticipated. The long-term cost implications of registration and reporting obligations as reported in this study appear to be absorbed relatively quickly after registration. The costs of compliance associated with the Dodd-Frank Act are, depending on size of the investment adviser, largely manageable.

This Article has five parts. Following this introduction Part II introduces the regulatory changes mandated by Title IV of the Dodd-Frank Act and describes the legal requirements in the Dodd-Frank Act pertaining to private fund managers. Part III outlines the methodological approach of the survey study. It introduces the survey instrument, data sources, sampling, coding, and coding constraints, and evaluates possible selection bias issues. Part IV discusses the results of the survey study with descriptive statistics and presents the substantive results of the study in summary graphs. Part V summarizes the key findings, implications for hedge fund policy, and possible implications for future research.

## II. Dodd-Frank Act Reform of the Private Fund Industry

The fundamental reshaping of the regulatory landscape for the private fund industry through Title IV, the JOBS Act, and the SEC's continuing development of the regulatory framework are the culmination of over seventy years of regulatory developments.

RUANE & MICHAEL V. SEITZINGER, CONG. RESEARCH SERV., R40783, HEDGE FUNDS: LEGAL STATUS AND PROPOSALS FOR REGULATION (2009). There were additional calls from regulators and international bodies. *See* G20 WORKING GROUP 1, ENHANCING SOUND REGULATION AND STRENGTHENING TRANSPARENCY ii-iii (2009), http:// cdm16064.contentdm.oclc.org/cdm/ref/collection/p266901coll4/id/2932; TECHNICAL COMM., IOSCO, HEDGE FUNDS OVERSIGHT: FINAL REPORT (2009), http:// www.iosco.org/library/pubdocs/pdf/IOSCOPD293.pdf; Robert J. Bianchi & Michael E. Drew, *Hedge Fund Regulation and Systemic Risk*, 19 GRIFFITH L. REV. 6, 20–25 (2010) (documenting the calls for proposed hedge fund regulatory reform post-crisis); Luis A. Aguilar, Comm'r, U.S. Sec. & Exch. Comm'n, Hedge Fund Regulation on the Horizon — Don't Shoot the Messenger (June 18, 2009), http://www.sec.gov/news/speech/ 2009/spch061809laa.htm.

Precipitated by the growth of the private fund industry in the 1980s, the SEC repeatedly attempted to register hedge fund advisers.[13] In its last attempt in 2004, the SEC required registration of hedge fund advisers.[14] However, the United States Court of Appeals for the District of Columbia vacated the SEC's registration rule in *Goldstein v. SEC*.[15] The overwhelming majority of private fund advisers that had registered under the SEC's 2004 registration requirements deregistered after the *Goldstein* decision.[16] The global financial crisis of 2008–2009 again highlighted the concern over private funds' role in global financial markets[17] and facilitated intensifying scrutiny of the private fund industry.[18]

For the first time in the history of the private fund industry, Title IV authorized the SEC to promulgate rules requiring registration and enhanced disclosure for private fund advisers.[19]

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[13] *See* Kaal, *supra* note 3, Part II.

[14] Registration Under the Advisers Act of Certain Hedge Fund Advisers, Investment Advisers Act Release No. 2333, 69 Fed. Reg. 72,054 (Dec. 20, 2004) (codified as amended at 17 C.F.R. pts. 275 & 279); *see also* Troy A. Paredes, *On the Decision to Regulate Hedge Funds: The SEC's Regulatory Philosophy, Style, and Mission*, 2006 U. ILL. L. REV. 975, 976; *infra* Part II.

[15] *Goldstein v. SEC*, 451 F.3d 873 (D.C. Cir. 2006).

[16] *See* Karen L. Anderberg*, Is Deregistration as an Adviser with U.S. SEC an Option?: 1 February 2007 Deadline Approaches*, DECHERT (Jan. 2007), http://goo.gl/evY34p ("[M]any hedge fund advisers that registered with the SEC have already deregistered, and others are now contemplating deregistration.").

[17] Maria Strömqvist, *Hedge Funds and Financial Crises*, 1 ECON. REV. 87, 89–90 (2009), http://www.riksbank.se/upload/Dokument_riksbank/Kat_publicerat/pov_sve/eng/stromqvist2009_1_eng.pdf ("The high degree of leverage entails risks for the counterparties of the hedge funds (for example the lenders) and the failure of a fund may therefore have contagion effects in the financial system."); Reint Gropps, *How Important Are Hedge Funds in a Crisis*?, FRBSF ECON. LETTER, Apr. 14, 2015, at 1-2 ("[H]edge funds may be the most important transmitters of shocks during crises, more important than commercial banks or investment banks"); Photis Lysandrou, *The Real Role of Hedge Funds in the Crisis*, FIN. TIMES (Apr. 1, 2012, 6:55 AM), http://www.ft.com/cms/s/0/e83f9c52-6910-11e1-9931-00144feabdc0.html#ixzz1zmj84oze (registration required) ("Had it not been for hedge funds' intermediary position between the investors seeking yield on the one hand and the banks that created the high yielding securities on the other, the supply of these securities, known as collateralised debt obligations, would never have reached the proportions that were critical in precipitating the near collapse of the whole financial system."). *But see* Llyod Dixon et al., *supra* note 10, at 33 (providing evidence that hedge funds did not cause the crisis although they may play an important role in the future).

[18] *See* note 12.

[19] Dodd-Frank Act §§ 402–408.

Title IV requires private fund advisers with more than $150 million assets under management (AUM) to register with the SEC as investment advisers.[20] In addition to exempting private fund advisers with less than $150 million AUM from registration,[21] Title IV also exempts foreign private advisers with less than $100 million AUM and fewer than fifteen clients and investors in the United States,[22] advisers to clients on investments other than private funds,[23] and venture capital fund advisers.[24] While private fund advisers with less than $150 million AUM are not per se required to register, they must maintain records and provide the SEC with

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[20] *See Id*. at § 408 ("The Commission shall provide an exemption from the registration requirements under this section to any investment adviser of private funds, if each of [sic] such investment adviser acts solely as an adviser to private funds and has assets under management in the United States of less than $150,000,000."); *see also id*. at § 403 (striking private adviser exemption under section 203(b)(3) of the Advisers Act, thereby precluding many private fund advisers from avoiding registration); Rules Implementing Amendments to the Investment Advisers Act of 1940, Investment Adviser Release No. 3221, 76 Fed. Reg. 42,950, 42,955 (July 19, 2011) (codified as amended at 17 C.F.R. pts. 275 & 279) ("We are adopting revisions to the instructions to Part 1A of Form ADV to implement a uniform method for advisers to calculate assets under management that will be used under the Act for regulatory purposes in addition to assessing whether an adviser is eligible to register with the Commission."); Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers with Less Than $150 Million in Assets Under Management, and Foreign Private Advisers, Investment Advisor Release No. 3222, 76 Fed. Reg. 39,646, 39,666 (July 6, 2011) (codified as amended at 17 C.F.R. pt. 275) (providing an exemption from registration for advisers with less than $150 million in private fund assets under management in the United States); SEC. & EXCH. COMM'N, OMB NO. 3235-0049, FORM ADV, UNIFORM APPLICATION FOR INVESTMENT ADVISER REGISTRATION AND REPORT BY EXEMPT REPORTING ADVISERS, pt. 1, 6-9 (2014) [hereinafter FORM ADV], http://www.sec.gov/about/forms/formadv.pdf. (explaining how to calculate regulatory assets under management); *Id*., pt. 1A, at 5 (requiring exempt reporting advisers to check that they qualify for an exemption from registration: (i) "as an adviser solely to one or more venture capital funds" or (ii) because they act "solely as an adviser to *private funds* and have assets under management in the United States of less than $150 million").

[21] Dodd-Frank Act, § 408.

[22] *Id.* §§ 402–403 (stating that in order to qualify for the exemption, foreign private advisers cannot have a place of business in the United States, cannot hold themselves out to the U.S. public as an investment adviser, and cannot have more than $25 million AUM attributed solely to U.S. clients and investors). *But see id.* § 402(a) (allowing the SEC to exercise its rulemaking powers and raise this amount).

[23] *Id.* § 410.

[24] *Id.* § 407.

annual reports or any other reports that the SEC deems appropriate or necessary to protect investors.[25]

Investment advisers that registered with the SEC under Title IV were required to file an amendment to Form ADV.[26] Registered investment advisers and exempt reporting advisers[27] are required under amended Form ADV to report to the SEC information regarding the private funds they manage,[28] including information about investment strategy, fund structure, ownership, gross asset value, the scope of services provided, the fund's use of consultants and other gatekeepers,[29] and the number and types of their clients.[30] Under revised Form ADV, advisers must report their gross defined Regulatory Assets Under Management (RAUM) rather than net RAUM, disabling the deduction of outstanding debt or other accrued but unpaid liabilities from totals.[31] Advisers must also identify the percentage of the adviser's total RAUM owned by each particular type of

[25] *Id.* § 408.

[26] *See* 17 C.F.R. § 275.203A-5(b) (2015); *see also* Rules Implementing Amendments to the Investment Advisers Act of 1940, 76 Fed. Reg. at 42,953–54 (discussing rule 203A-5(b), which provides that SEC-registered advisers not required to file an annual updating amendment between January 1, 2012, and March 30, 2012, will file an other-than-annual amendment, but they will complete all of the items on Part 1A of Form ADV, not just the items required to be updated in a typical other-than-annual amendment).

[27] FORM ADV, *supra* note 20, pt. 1A, at 5–6 (requiring exempt reporting advisers to disclose only a limited subset of items on Form ADV).

[28] *Id.*

[29] Rules Implementing Amendments to the Investment Advisers Act of 1940, 76 Fed. Reg. at 42,965–66 (requiring advisers to complete section 7.B.(1) of Schedule D for any private fund that the adviser manages when, previously, Item 7 required advisers only to complete section 7.B.(1) of Schedule D for "investment-related" limited partnerships or limited liability companies that the adviser or a related person advised). Part A of Section 7.B.(1) "requires an adviser to provide basic information regarding the size and organizational, operational, and investment characteristics of each fund." *Id.* at 42,965. Part B of the same section "requires advisors to report information concerning five types of [private fund] service providers that generally perform important roles as 'gatekeepers'"—which will both identify gatekeepers and give investors an idea of what kinds of roles particular gatekeepers play. *Id.* at 42,968. For example, advisers must indicate if a prime broker has custody of fund assets. *Id.* Information reported on this section of Schedule D will be publicly available. *Id.* at 42,965.

[30] FORM ADV, *supra* note 20, pt. 1A, at Item 5.C–D.

[31] Rules Implementing Amendments to the Investment Advisers Act of 1940, 76 Fed. Reg. at 42,956.

client[32] and the compensation arrangements the adviser uses.[33] Investment advisers are also required to disclose the types of services they provide, including financial planning services, portfolio management, pension consultation, security rating, and educational seminars.[34]

Revised Form ADV also helps the SEC assess investment advisers' custodial practices. In addition to disclosure of whether the adviser or a related person has custody of client assets,[35] cash, bank accounts, or securities,[36] revised Form ADV requires investment advisers to disclose the total U.S. dollar amount of clients' cash, bank accounts, and securities held in custody and the total number of clients subject to adviser or related-person custody.[37] Advisers with custody of client assets are required to disclose any irregularities, and they must disclose the number of persons, including the adviser and related persons, acting as qualified custodians for clients in connection with advisory services provided to those clients.[38]

Following its Title IV mandate,[39] the SEC introduced a controversial new form, Form PF (Private Funds).[40] Form PF

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[32] FORM ADV, *supra* note 20, pt. 1A, at Item 5.D.(2).
[33] *Id.* at Item 5.E.
[34] *Id.* at Item 5.G.; *see also id.* at Item 5.H (requiring disclosures pertaining to the number of clients the adviser provided with financial planning services); *id.* at Item 5.I (asking whether the adviser participates in a wrap fee program); *id.* at Item 5.J (asking whether the adviser previously indicated that it provides investment advice only with respect to limited types of investments).
[35] FORM ADV, *supra* note 20, pt. 1A, at Item 9; *see also Id.* at Glossary of Terms 2 ("[An adviser has] custody if a *related person* holds, directly or indirectly, client funds or securities, or has any authority to obtain possession of them, in connection with advisory services [the adviser] provides to clients.").
[36] *Id*. pt. 1A, at Item 9.A–B.
[37] *Id.*
[38] *Id.* at Item 9.D (asking whether the adviser or a related person acts as a "qualified custodian" for clients in connection with advisory activities provided to clients and requiring the adviser to identify any related person who acts as a qualified custodian in § 7.A of Schedule D, regardless of whether the person is operationally independent under rule 206(4)-2 of the Advisers Act).
[39] The Act mandates hedge fund adviser registration to increase record keeping and disclosure. *See* Dodd-Frank Act § 408 ("The Commission shall require investment advisers exempted by reason of this subsection to maintain such records and provide to the Commission such annual or other reports as the Commission determines necessary or appropriate in the public interest or for the protection of investors.").
[40] SEC. & EXCH. COMM'N, OMB NO. 3235-0679, FORM PF, REPORTING FORM FOR INVESTMENT ADVISERS TO PRIVATE FUNDS AND CERTAIN COMMODITY POOL OPERATORS AND COMMODITY TRADING ADVISORS (2014) [hereinafter

increased the level of regulatory oversight of private funds to unprecedented levels.[41] For the first time in the history of the private fund industry, in the periodic reports[42] mandated via Form PF,[43] registered investment managers were required to disclose information about themselves, the funds they manage, and their investors,[44] including information on the products used by the investment adviser, fund performance and changes in performance, financing information, risks metrics, strategies used, credit exposure, and positions held by the investment adviser.[45] Form PF requires a breakdown of the net asset value (NAV) that the investment manager manages,[46] including the percentage of the reporting fund's net asset value that was managed using high-frequency trading strategies.[47] It also requires investment advisers to disclose the five trading counterparties to which the reporting fund has the greatest net counterparty credit exposure,[48] including the dollar amount owed to each creditor.[49] Other important Form

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FORM PF], http://www.sec.gov/about/forms/formpf.pdf; FORM ADV, *supra* note 20.

[41] *Id. See* Dodd-Frank Act §§ 401–416 (incorporating the PFIARA in Title IV); *accord Proposal for a Directive of the European Parliament and of the Council on Alternative Investment Fund Managers and Amending Directives 2004/39/EC and 2009/.../EC*, COM (2009) 207 final (Apr. 30, 2009); *Investment Funds*, EUROPEAN COMMISSION, http://ec.europa.eu/internal_market/investment/alternative_investments_en.htm (last updated Nov. 27, 2015) (providing additional materials on AIFM).

[42] Dodd-Frank Act § 404(b); 17 C.F.R. § 275.204(b)-1 (2015); Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF, Investment Advisers Act Release No. 3308, 76 Fed. Reg. 71,128, 71,140–42 (Nov. 16, 2011) (codified as amended at 17 C.F.R. pts. 275 & 279), http://www.gpo.gov/fdsys/pkg/FR-2011-11-16/pdf/2011-28549.pdf.

[43] FORM PF, *supra* note 40, at 2; *see also* 17 C.F.R. § 275.204(b)-1 (2015) (requiring private fund advisers to file Form PF with the SEC periodically); 17 C.F.R. § 4.27 (2015) (requiring private fund advisers to file Form PF if they are registered as commodity pool operators or commodity trading advisers); Reporting by Investment Advisers, 76 Fed. Reg. at 71,239.

[44] *See* 17 C.F.R. § 279.9 (2015) (establishing filing requirements for Form PF); FORM PF, *supra* note 40, § 1a–b.

[45] *See* FORM PF, *supra* note 40, *passim*.

[46] FORM PF, *supra* note 40, § 1a, Item B.3 (including the following private fund categories: (a) hedge funds, (b) liquidity funds, (c) private equity funds, (d) real estate funds, (e) securitized asset funds, (f) venture capital funds, (g) other private funds, (h) funds and accounts other than private funds).

[47] *Id.* § 1c, Item B.21.

[48] *Id.* § 1c, Items B.22–23.

[49] *Id.* § 2b, Item D.47.

PF disclosures include the requirement that the manager identify changes in market factors and their effect on the long and short components of the portfolio as a percentage of NAV,[50] any information about the counterparties' collateral and other credit support posted to the respective reporting funds,[51] as well as trading and clearing mechanisms subject to liquidity constraints and the duration of those constraints.[52]

The only SEC regulation passed since 2012 addressed money market funds, revised section 3 of Form PF and general instruction 15, and made minor changes to the glossary of terms (adding and revising certain items).[53] The SEC periodically releases "Investment Management Regulatory Updates" and posts responses to frequently asked questions regarding Form PF.[54]

Evidence exists that Form PF created challenges for the private fund industry. Although prior studies have acknowledged that the SEC's mandated collection of private fund data via Form PF created several core challenges for the private fund industry, these studies do not sufficiently clarify the long-term impact of the Form PF disclosure requirements.[55] For instance, Form PF required disclosures of counterparty credit exposure constitute sensitive information that often cannot be readily determined by the individual fund managers. While the total number of investment advisers filing Form PF will be relatively small, they are likely to represent a substantial portion of the assets of the industry. The SEC estimates that 230 U.S. hedge fund advisers with at least $1.5 billion in RAUM attributable to hedge funds at the end of any month in the prior fiscal quarter will file Form PF.[56] The SEC expects this relatively small number of advisers to

[50] *Id.* § 2b, Item C.42.
[51] *Id.* § 2b, Item B.36.
[52] *Id.* § 1c, Item B.24.
[53] Money Market Fund Reform, Amendments to Form PF, Investment Company Release No. 311166, 79 Fed. Reg. 47,735, 47,863 (Aug. 14, 2014) (codified as amended at 17 C.F.R. pts. 230, 239, 270, 274 & 279).
[54] *Form PF Frequently Asked Questions,* U.S. SEC. & EXCH. COMM'N , http://www.sec.gov/divisions/investment/pfrd/pfrdfaq.shtm1 (last visited Jan. 1, 2016).
[55] Kaal, *supra* note 3; Kaal, *Basel III*, *supra* note 9; Wulf A. Kaal, *Hedge Funds' Systemic Risk Disclosures in Bankruptcy*, 22 AM. BANKR. INST. L. REV. 195 (2014) [hereinafter Kaal, *Private Funds' Systemic Risk Disclosures*]; Wulf A. Kaal, *Private Fund Valuation – Retailization, Regulation, and Investor Suitability*, 28 REV. BANKING & FIN. L. 581 (2009) [hereinafter Kaal, *Private Fund Valuation*].
[56] Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF, 76 Fed. Reg. at 71,135.

account for 80% of total hedge fund assets under management in the United States.[57] Similarly, the approximately 155 investment advisers managing over $2 billion in private equity fund assets may represent roughly 75% of the U.S. private equity fund industry.[58] Form PF data provided by the SEC's Risk and Examinations Office for the fourth quarter of 2104 show that the net asset value is around $3,399 billion for hedge funds, $2,672 billion for Qualifying Hedge Funds and $1,744 billion for Private Equity.[59]

A 2013 survey study quantified the compliance costs associated with Form PF.[60] While Form PF compliance costs for first time filers were under $10,000 (59.18% of respondents), the cost of subsequent annual Form PF filings amounted to no more than $5,000 (57.14% of respondents), with larger quarterly filing private fund advisers incurring substantially higher compliance costs than their annually filing peers.[61] Time spent on filing Form PF is consistent with cost estimates.[62] Survey respondents agreed with the definitions or instructions in Form PF (59.18% of respondents) and appreciated SEC guidance and flexibility in responding to questions regarding Form PF (72.92% of respondents). Survey respondents also deemed their existing internal reporting systems adequate to capture the information required by Form PF (65.22% of respondents) and refrained from employing service-providers for the completion and filing of Form PF (72.92% of respondents). While data inconsistencies appear to be remain as a concerns,[63] concerns over the burdensome nature of Title IV's mandatory private fund adviser registration and disclosure requirements[64] seem to be mostly unfounded.[65]

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[57] *Id.*

[58] *Id.* (*citing* PREQIN, PRIVATE EQUITY INDUSTRY DATA PROVIDED BY PREQIN (2011), http://www.sec.gov/comments/s7-05-11/s70511-69.pdf).

[59] SEC. & EXCH. COMM'N, DIV OF INVEST. MGMT., RISK & EXAMINATIONS OFFICE, PRIVATE FUNDS STATISTICS: FOURTH CALENDAR QUARTER 2014 5 (2015), https://www.sec.gov/divisions/investment/private-funds-statistics/private-funds-statistics-2014-q4.pdf.

[60] Kaal, *supra* note 3.

[61] *Id.* at 315.

[62] Private fund advisers used only one to three individuals to complete Form PF (67.35% of respondents) and private fund advisers' staff spent less than 50 hours to complete Form PF (69.39% of respondents). *Id.*

[63] Mark D. Flood et al., *Gauging Form PF: Data Tolerances in Regulatory Reporting on Hedge Fund Risk Exposures* 26 (Office of Fin. Research, Working Paper 15-13), https://financialresearch.gov/working-papers/files/OFRwp-2015-13_Gauging-Form-PF.pdf.

[64] *See supra* note 8 and accompanying text. SEC. & EXCH. COMM'N, IMPLICATIONS OF THE GROWTH OF PRIVATE FUNDS 90 (2003),

## III. Methodology

To explore the longer-term effects of Title IV of the Dodd-Frank Act, this study analyzes a sampling of individual investment advisers from a population of private fund investment advisers registered in the United States. Respondents (N=69) answered questions in several categories. Question categories included, among others, the long-term effect of reporting and disclosure rules on private funds, the cost of compliance, compliance measures, strategic responses, the long-term effect of reporting and disclosure rules on the private fund industry, the effect of the regulatory regime on assets under management, and the effect of the regulatory regime on profitability.

The population for the survey consisted of 1267 registered private fund advisers. To identify the population, the author obtained from the SEC's Investment Adviser Registration Depository (IARD) website[66] a dataset for the relevant population, comprising 12,598 registered investment adviser firms.[67] To ensure the sample was random, the author applied several filters not biased towards certain subgroups of hedge fund advisers.[68]

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http://www.sec.gov/news/studies/hedgefunds0903.pdf ("Many of those opposing required registration expressed a strong preference for leaving the private fund industry 'unregulated.'").

[65] Kaal, *Hedge Fund Manager Registration*, *supra* note 3, at 316.

[66] The SEC collects data pertaining to registered private fund advisers on its IARD website*: Historical Archive of Investment Adviser Reports*, U.S. SEC. & EXCH. COMM'N, http://www.sec.gov/foia/iareports/inva-archive.htm (last modified January 4, 2016); *see also Division of Investment Management: Electronic Filing for Investment Advisers on IARD*, U.S. SEC. & EXCH. COMM'N , https://www.sec.gov/iard (last modified Aug. 12, 2015) (providing information on the IARD and how to register or obtain information on investment advisers).

[67] *See Historical Archive of Investment Adviser Reports*, *supra* note 66.

[68] Author first filtered for affirmative responses to Item 7.B in Form ADV, "Are you an adviser to any *private fund*?". FORM ADV, *supra* note 20, pt. 1A, at Item 7.B. This initial filter decreased the dataset significantly, as 4054 firms responded in the affirmative and 327 firms did not answer the question, for a total of 4381 firms. To ensure only U.S. hedge fund advisers were included in the population, the Author removed investment adviser firms that had not reported a U.S. phone and fax number, including any firms that reported phone or fax numbers with more than ten numbers. Thereafter, the Author filtered for firms that had completed the revised version of Form ADV, dated November 2011. *See id.* These filters resulted in a subset of 3824 investment advisers. Finally, the Author filtered the dataset for investment adviser firms with the status effective dates as of November 1, 2011, resulting in 1264 firms. The Author added three investment advisers that volunteered responses without direct

The resulting dataset of 1267 firms included investment adviser firms that (1) advise private funds, (2) have contact information in the United States, (3) completed the November 2011 version of Form ADV, and (4) have a status effective date as of November 1, 2011. The author had no control over the selection of the sample. All respondents were approached using the same methodology and all volunteered their participation. The author tested the survey questions through more than twenty rounds of test runs with registered industry representatives and academics working in the field, and he regularly and repeatedly checked the coding for accuracy and internal consistency.

Sampling constraints can significantly affect survey studies. Survey studies with private fund advisers are subject to sampling constraints because private fund advisers generally prefer confidentiality and privacy and generally oppose most publicity.[69] Most private fund advisers do not respond to survey questions so obtaining a substantial effective sample size for survey studies with private fund advisers is difficult. The response rate for this survey was 5.44% of a population of 1267. Obtaining the contact information for private fund advisers in the United States is difficult; it requires individual email searches for each adviser via the Internet. Although SEC Form ADV requires advisers to disclose the contact information of registrants' chief compliance officer, the SEC's IARD dataset does not list that contact information and did not include e-mail addresses.

The population and the sample of this study are not biased. Survey studies are often subject to sample selection bias. Sample selection bias can exist when researchers select participants with shared traits the researcher hopes to explain and the researcher uses nonstatistical selection procedures. In the survey study context, obtaining information through voluntary responses can create an inherent selection bias because people with a special interest may be more likely to respond to the survey questions. In this study, all respondents were required to comply with Title IV. The author also had no control over the selection of the sample. Each member of the population of hedge fund advisers had a known nonzero chance of being selected as part of the sample. The author approached all respondents using the same methodology, and, as previously noted, all respondents volunteered their responses. Respondents in either sample answered identical

solicitation by the Author after confirming that these three investment advisers were listed in the SEC database, bringing the total number of firms to 1267.

[69] Reasons cited by respondents for not responding include a general policy of not responding to any surveys for privacy concerns and the advice of counsel not to participate in the survey, among other reasons.

survey instruments. The survey sample (N=69), 5.44% of the identified populations of 1267 private fund advisers, is representative of the population of registered private fund managers. There is no indication that respondents who did respond to the survey were different from non-respondents.

The modes of data collection for the survey were consistent. The single mode of data collection for this survey consisted of e-mails with electronic surveys. Mode effects are insignificant because each data collection method was based on the same questionnaire and respondents were asked the same sequence of questions. The only incentive offered to survey participants was the author's promise to share the results of the survey study with respondents upon completion of his work.

The author only used closed-ended questions to quantify items. Affirmative responses to closed-ended questions such as "Yes" and "No" categories were coded as "1." All closed-ended questions in the survey instrument were dichotomous and continuous, and all response options for closed-ended questions were exhaustive and mutually exclusive.

The author coded open-ended questions into response clusters. Survey questions two, three, four, five, nine, ten, eleven, and twelve allowed respondents to provide open-ended answers. Firms' responses to these open-ended questions were copied into a separate worksheet, along with a specifically assigned identification number for the survey response. The identification number was used to facilitate coding of the clustered responses into the combined coding sheet. The answers could then be tied to other Form ADV information and other survey questions. At least three respondents providing similar responses to a question, either by using identical words or meaning, justified the creation of a cluster category.

The anonymity of survey responses did not allow a broader descriptive statistical analysis of the sample. The author guaranteed complete anonymity to all survey respondents, which is an essential element in obtaining a sufficient response rate. While it is possible to make inferences and add a more detailed descriptive sample analysis based on the email addresses provided by respondents, the author did not include such an analysis because it often would have required making questionable inferences on identity of respondents and the fund advisers they represent. The author also decided not to make such inferences to protect the anonymity of survey participants.

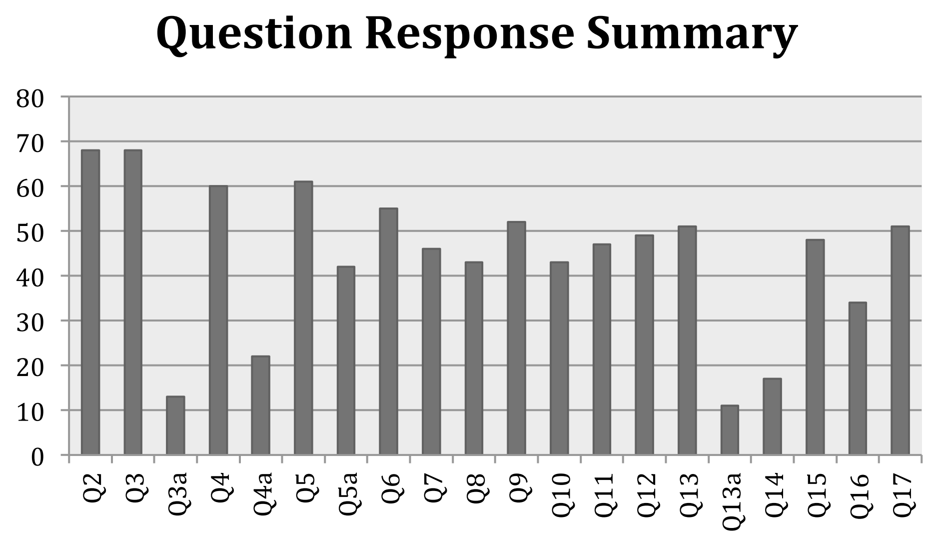


**Figure 1** - Response Summary for Survey Questions

Figure 1 shows the number of responses to each question in the survey instrument. The majority of survey participants completed the entire survey. The four questions with the lowest response rate were questions 3a, 4a, 13a, and 14. Survey coding as displayed in Figure 1 does not correspond with survey question count in Appendix A. Question 3a was an open-ended question asking "If yes, what strategic responses do you plan to implement". Question 4a was also an open-ended question: "[____]". It is important to note that Figure 1 shows the coding sheet response clusters, which is not consistent with the numbering in the hardcopy printout of the survey instrument in the Appendix.

## IV. Results

Figures 2 to 20 below and the accompanying text present the detailed results of the survey. The figures quantify compliance time and costs, compliance measures and the private fund industry's strategic responses to the implementation of the Dodd-Frank Act, the possible long-term effects of private fund registration, the implications of the disclosure requirements in the Dodd-Frank Act pertaining to private funds, the long-term effects of reporting and disclosure rules on private funds and the private fund industry, the effect of the regulatory regime on AUM, and the effect of the regulatory regime on profitability. This study supports policymakers in their assessment of long-term implications of Title IV for the private fund industry.

*1. Adviser Response to Dodd-Frank*

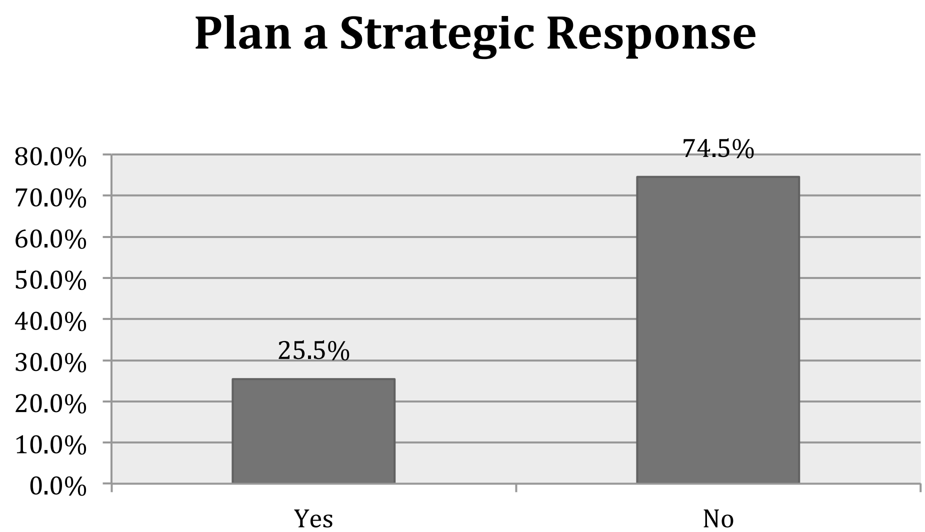


**Figure 2** - Advisers Who Plan a Strategic Response to Dodd-Frank.

Figure 2 indicates that a majority (74.5%) of private fund adviser respondents do not plan a strategic response to Title IV of the Dodd-Frank Act. “Strategic responses” can be interpreted as actions to avoid or limit the impact of Title IV. The responses in Figures 3 and 4 below show the common actions taken to comply with Title IV. However, in both Figures 3 and 4, the “other” response could entail strategic responses.

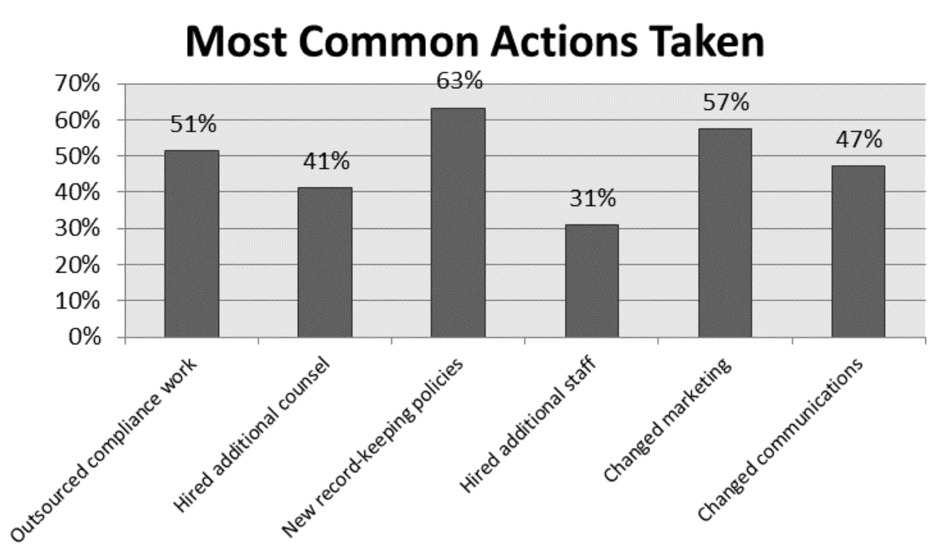

Figure 3 - Common Actions Taken in Response to Dodd-Frank.

Figure 3 shows that a majority of respondents have instituted measures in response to the requirements imposed by Title IV. The most common actions taken include: (1) outsourcing compliance work, (2) hiring additional counsel, (3) instituting new record-keeping policies, (4) hiring additional staff, (5) changing marketing materials, and (6) changing communications with investors. As opposed to responses displayed in Figure 4, most responses in Figure 3 reference compliance changes or updates but do not mention fundamental legal or strategic changes in response to the Dodd-Frank Act.

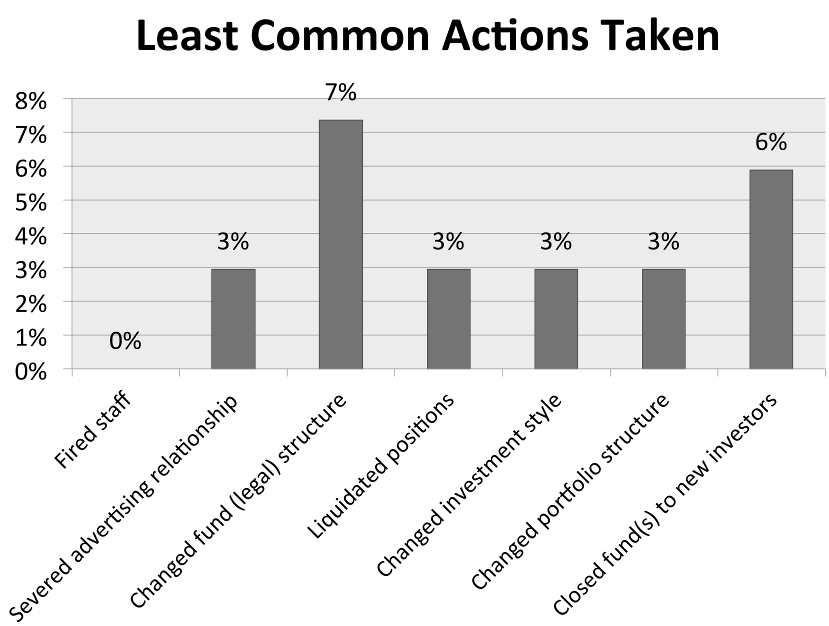


**Figure 4** - Least Common Actions Taken in Response to Dodd-Frank.

Figure 4 shows the least common actions taken in response to Title IV. Private fund advisers in the sample did not terminate existing employment relationships. Few respondents severed an advising relationship, changed funds' (legal) structure, liquidated positions, changed investment styles, changed portfolio structure, or closed funds to new investors. Figure 4 suggests that some funds are taking significant legal and/or strategic measures to address perceived issues associated with the Dodd-Frank Act.

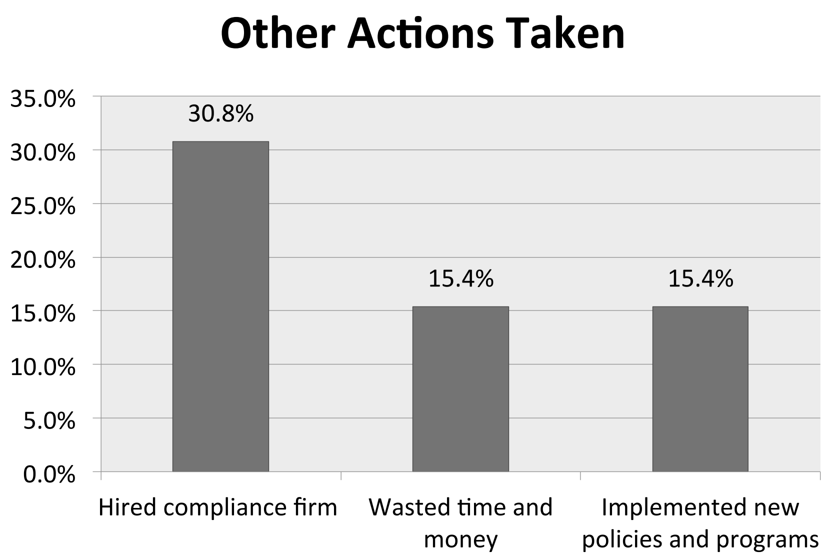


**Figure 5** - Other Actions Taken in Response to Dodd-Frank.

Figure 5 shows respondents' reactions to open-ended survey question 3b "other." 30.8% of respondents who answered this question hired a compliance firm, 15.4% suggested they otherwise wasted time and money in reacting to Dodd-Frank requirements, and 15.4 % suggested they implemented new policies and programs in response to the Dodd-Frank Act. The total count of respondents' references to "wasted time and money" allowed the coding of a response cluster and provides a sense of at least some respondents' perspective on the measures imposed by the Dodd-Frank Act. However, even in this survey question, the majority of respondents made simple reference to compliance measures, e.g., "hired a compliance firm".

*2. Compliance Cost*

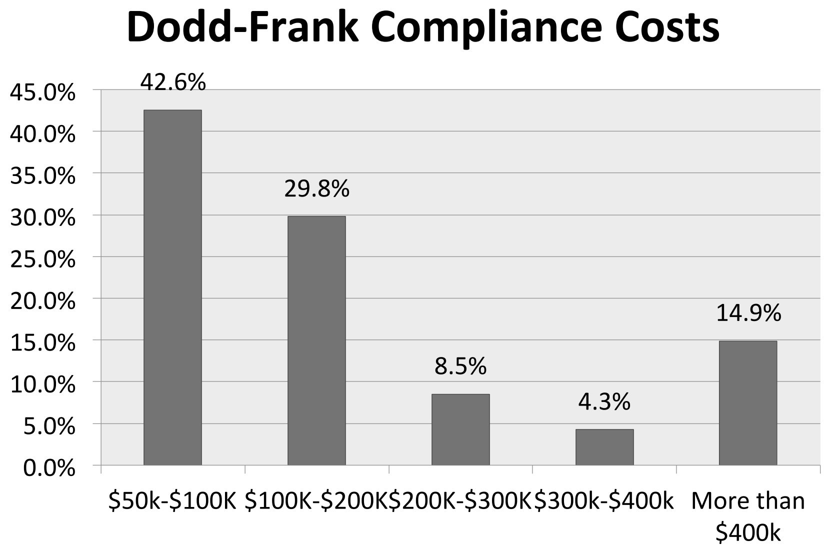


**Figure 6 -** Dodd-Frank Act Compliance Cost.

Figure 6 illustrates respondents' total cost of compliance with Title IV. A majority of respondents estimated compliance costs in the $50,000 to $200,000 range. However, a significant minority estimated total compliance costs will range from $200,000 to more than $400,000. Anecdotal evidence suggests that while up to $100,000 in additional compliance costs imposed by the Dodd-Frank Act can be a significant imposition on a smaller private fund adviser, for the majority of larger or mid-sized investment advisers those compliance costs can be relatively easily absorbed and/or passed on to their clients.

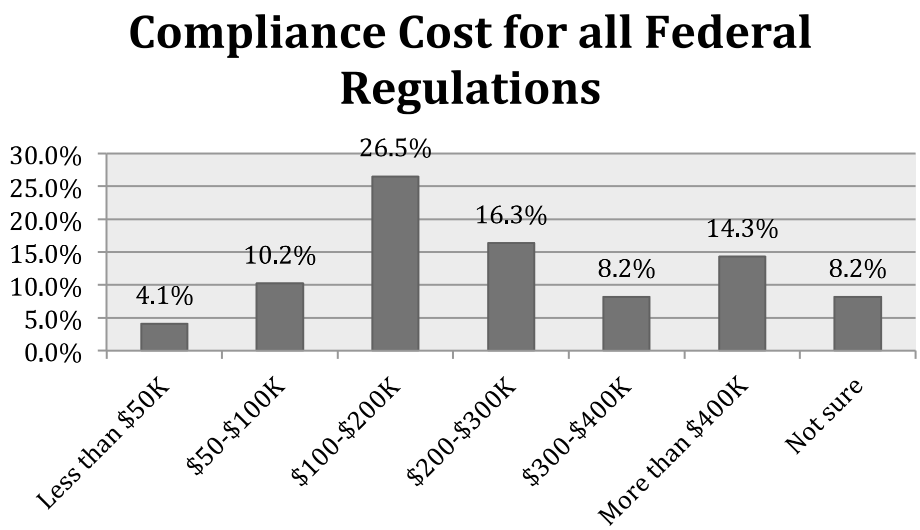


**Figure 7** - Annual Compliance Cost for all Federal Regulations.

Figure 7 shows private fund adviser respondents' estimations of total annual cost to comply with all federal regulations pertaining to the private fund industry. A considerable number of respondents estimated the cost at up to $100,000. Most respondents (26.5%), however, estimated the annual compliance cost for all federal regulations at between $100,000 and $200,000. A smaller group (14.3%) estimated the cost of compliance at more than $400,000 a year. Respondents' estimates in Figures 6 (Dodd-Frank Act compliance cost) and 7 (compliance costs associated with all federal regulation) are consistent in the trends they present, with majority responses for compliance costs associated with Dodd-Frank Act compliance in Figure 6 trailing overall compliance costs in Figure 7.

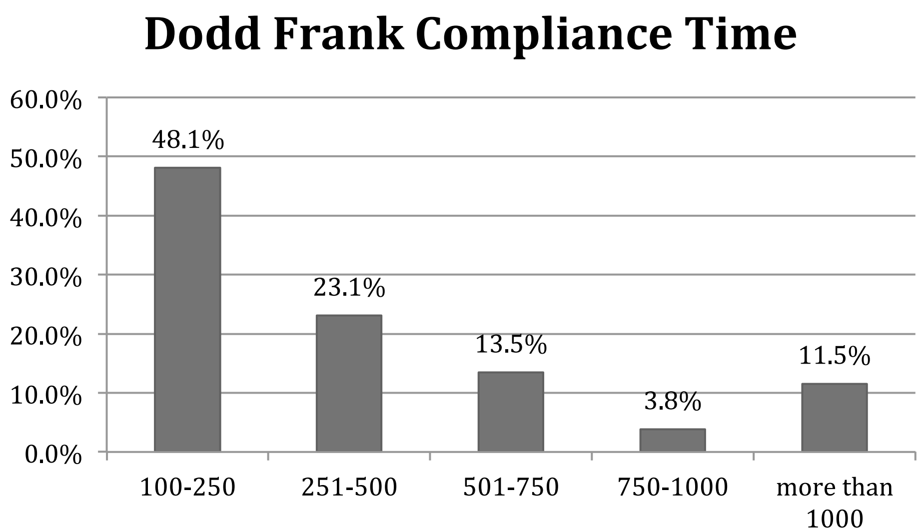


**Figure 8** - Hours Required To Comply with Dodd-Frank Act.

Figure 8 shows that although a clear majority of adviser respondents spent fewer than 500 hours complying with Title IV, a noticeable minority (11.5%) estimated they spent more than 1000 hours to comply with the requirements. Respondents' estimates in Figures 6 (Dodd-Frank Act compliance cost) and 8 are consistent in the trends they present. Time is a proxy for costs. The majority responses for Dodd-Frank compliance costs in Figure 6 are consistent with the majority responses for Dodd-Frank compliance time requirements in Figure 7.

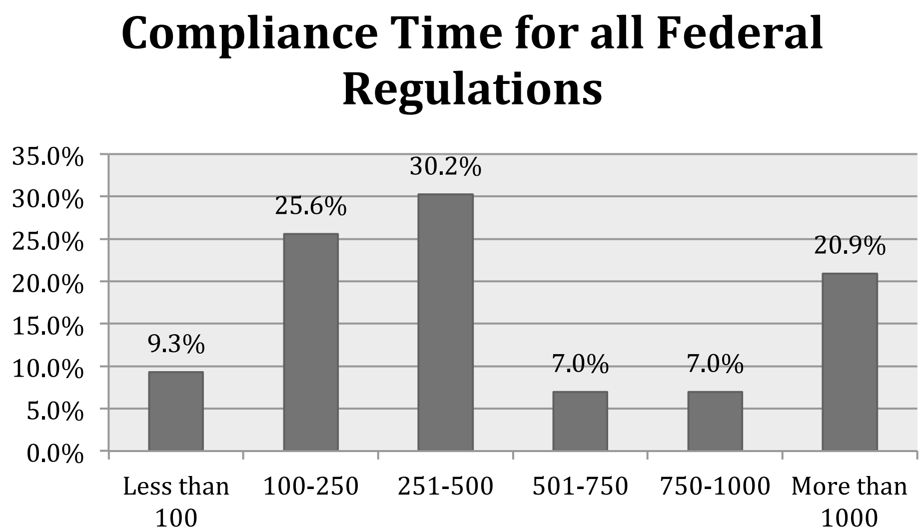


**Figure 9** - Annual Hours Required to Comply with All Federal Rules.

Figure 9 shows respondents' estimates for the hours needed to comply with all federal rules and regulations pertaining to private fund advisers. 55.8% of respondents estimated the total time required to comply with all federal regulations at between 100 and 500 hours. However, a noticeable minority (20.9%) estimated it at above 1000 hours. Respondents' estimates in Figures 8 (Dodd-Frank Act compliance time) and 9 (compliance time associated with all federal regulation) are consistent in the trends they present, with majority responses for compliance costs associated with Dodd-Frank Act compliance in Figure 8 trailing overall compliance costs in Figure 9.

*3. Assets Under Management*

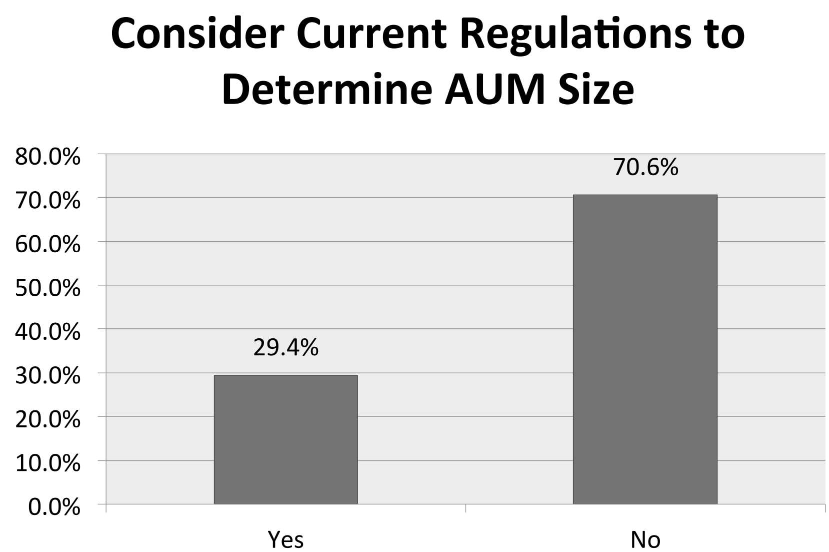


**Figure 10** - Percentage of Advisers Considering the Regulatory Regime in the AUM Decision.

Figure 10 illustrates the responses to Survey Question 7: "Would you take the current regulatory regime into account in determining the appropriate size of asset[s] (AUM) for your fund(s)?" Of those who responded, 70.60% would not take the current regulatory regime into account in determining the AUM size of their funds. In light of the fact that private fund advisers with less than AUM $150 million do not have to comply with the majority of registration and disclosures requirements under the Dodd-Frank Act and the Form PF quarterly reporting threshold for larger funds is at $1.5 billion, the majority response to Survey Question 7 implies that the majority of private fund advisers in the United States are not considering changing their AUM in order to lower their Dodd-Frank Act compliance costs.

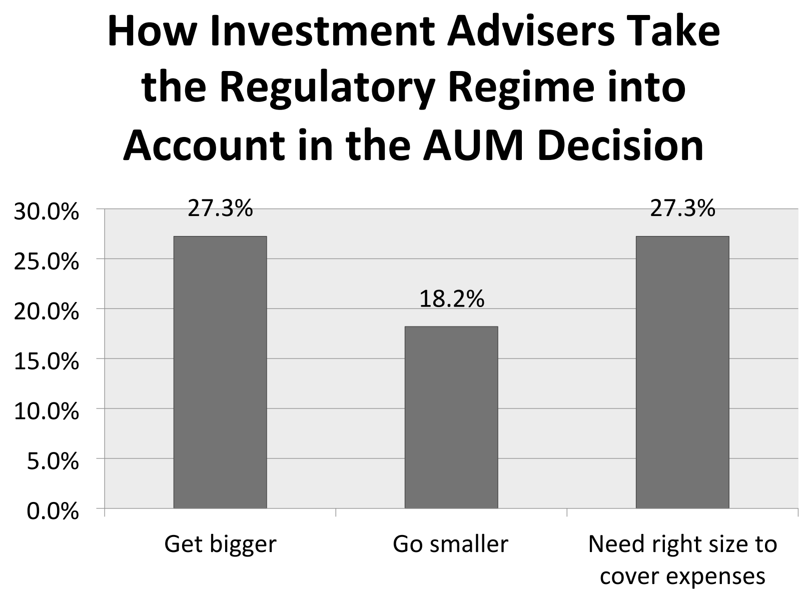


**Figure 11** – How Investment Advisers Take the Regulatory Regime into Account in the AUM Decision.

Figure 11 shows the majority of clustered responses pertaining to Survey Question 7b: "Would you take the current regulatory regime into account in determining the appropriate size of asset[s] (AUM) for your fund(s)?. . . If Yes—How would you take it into account?" A majority of respondents stated that as a result of the current regulatory regime their AUM would need to change. While 18.2% would lower their AUM to avoid the regulatory hassle, 27.3% would actually still want to increase their AUM. Another 27.3% indicated a desire to attain the right size to cover expenses.

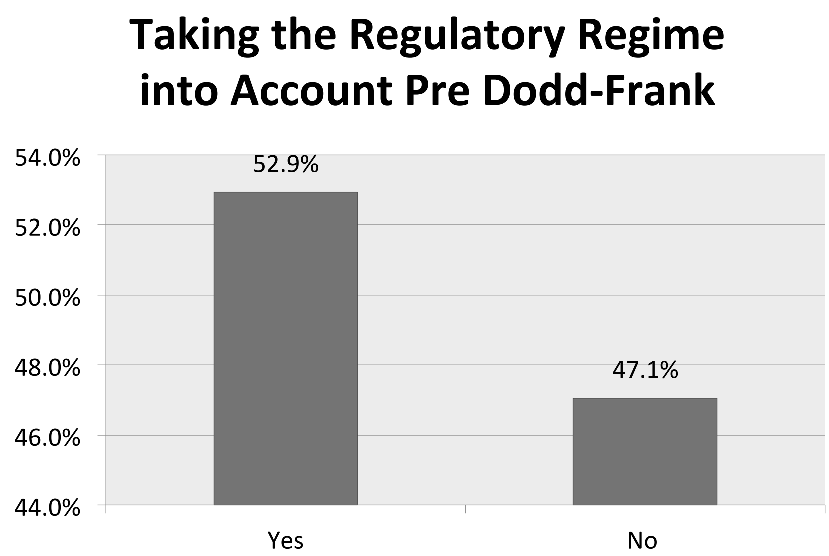


**Figure 12** - When Advisers Considered the Regulatory Regime in the AUM Decision.

Figure 12 shows the responses to Survey Question 7.b.ii.: “Did you take [the regulatory regime] into account before the Dodd-Frank Act was enacted?” It shows that a majority of respondents did in fact take the regulatory regime into account before Dodd-Frank, implying that Dodd-Frank did not make much difference in the way respondents run their business. However, a significant minority (47.1%) did not consider the regulatory regime in determining the appropriate size of AUM. The minority’s response is consistent with private fund advisers’ notion that in order to generate sufficient returns and improve profits/fees they need to grow their AUM.

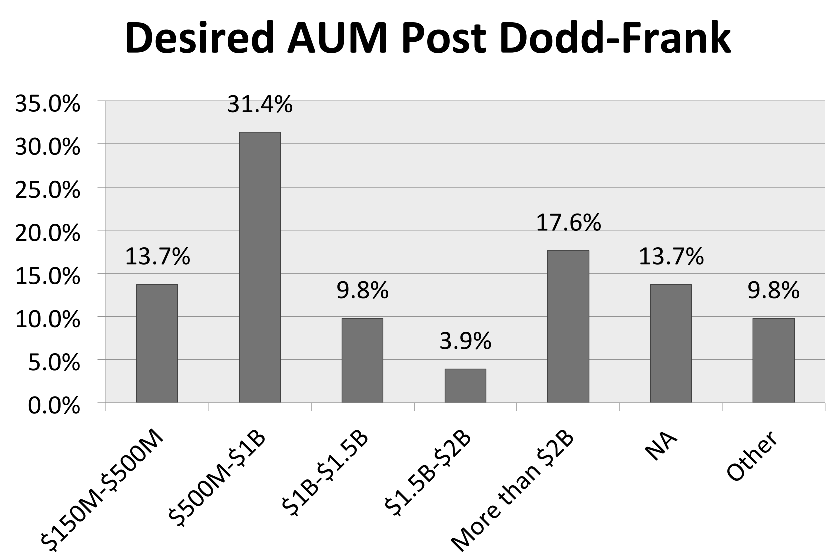


**Figure 13** - Desired AUM Post Dodd-Frank.

Figure 13 illustrates that the largest number of respondents (33.3%) prefer an AUM size of between $500 million and $1 billion. No clear majority emerges as to the preference pertaining to the $1.5 billion Form PF quarterly reporting threshold for larger funds. Moreover, the majority of private fund advisers in the United States are not considering the registration threshold of $150 million AUM and the Form PF quarterly reporting threshold for larger private fund advisers of $1.5 billion. The AUM size desired by the largest number of respondents is consistent with anecdotal evidence suggesting optimal portfolio and position setup is possible between $500 million and $1 billion.

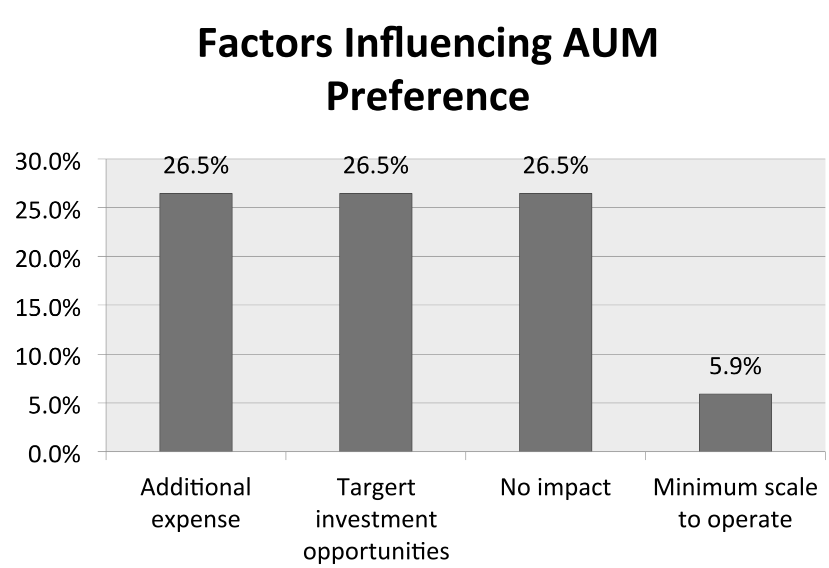

**Figure 14** - Factors Influencing AUM Preference.

Figure 14 illustrates the array of responses pertaining to a survey question about factors that influenced respondents' AUM preferences. Interestingly, the respondents divided evenly among three factors that influenced their AUM preferences. 26.5% of respondents opined that there was no impact on their AUM preference. Equally represented, however, are two factors that did influence respondents AUM preferences, namely target investment opportunities and additional expenses.

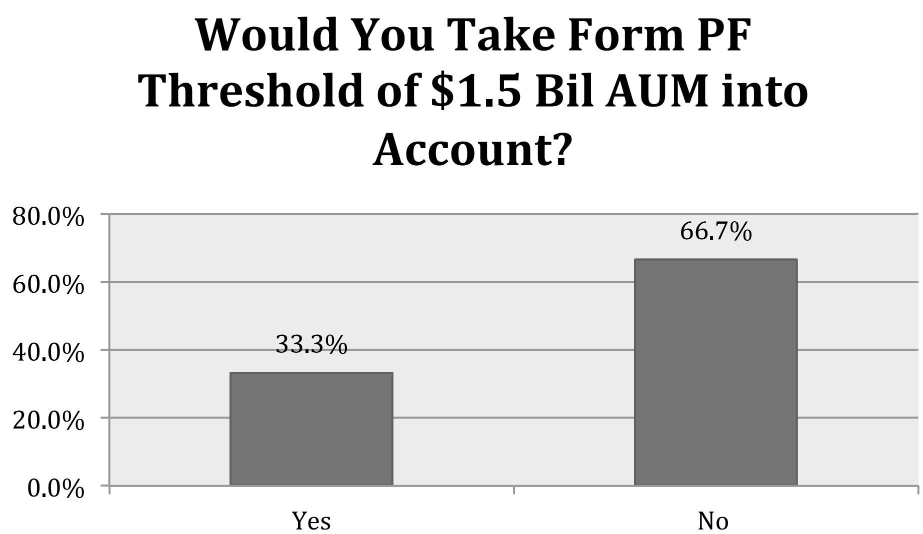


**Figure 15** - Advisers Who Considered the $1.5 Billion Form PF Threshold in the AUM Decision.

Figure 15 illustrates that the majority of adviser respondents (66.7%) did not take the $1.5 billion AUM threshold under Form PF for quarterly reporting into account in determining the appropriate size of AUM for the fund(s) they manage.

*4. Fund Earnings*

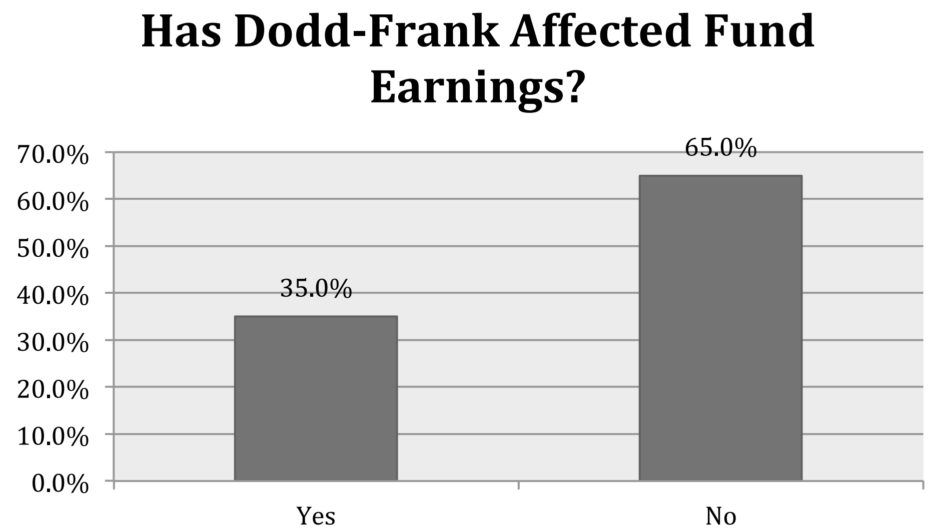


**Figure 16** - Dodd-Frank Effect on Fund Earnings.

Figure 16 shows that 65% of adviser survey respondents believed that fund earnings were not affected by the Dodd-Frank Act.

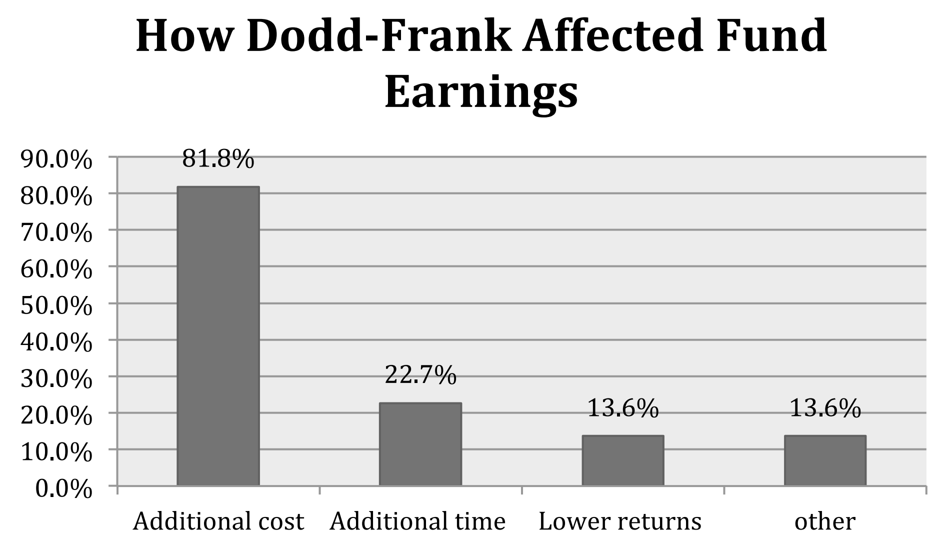


**Figure 17** - How Dodd-Frank Affected Fund Earnings.

Figure 17 illustrates that the majority of those respondents who believed that Dodd-Frank affected their fund(s) earnings blamed additional compliance costs associated with Dodd-Frank. Additional time (for compliance measures) was seen by some survey respondents as a factor affecting fund earnings with is consistent with the majority of respondents' concern pertaining to additional compliance cost. It is unclear how the Dodd-Frank Act may have affected fund earnings by creating lower returns (13.6 % of respondents).

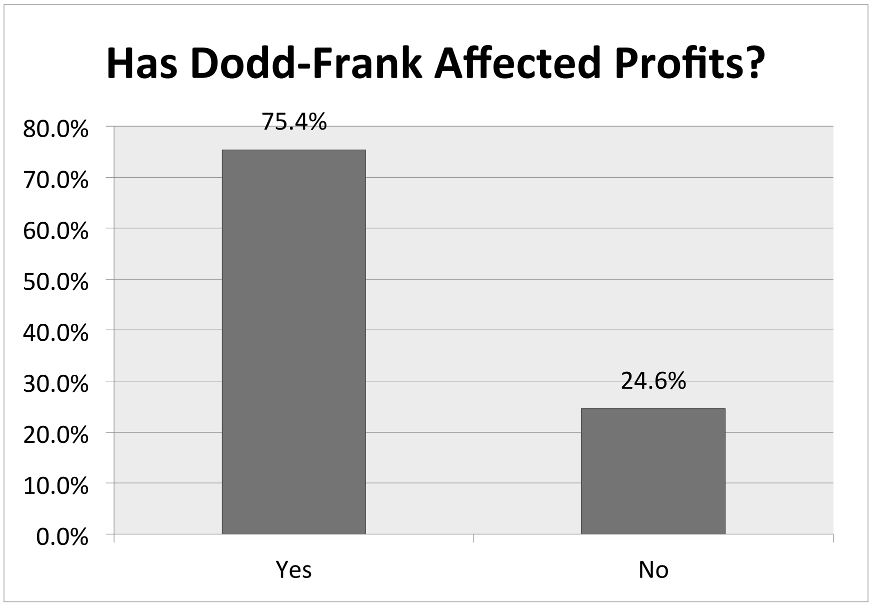


**Figure 18** - Dodd-Frank Effect on Management Company Profits.

Figure 18 highlights the majority of respondents' assessment of the Dodd-Frank effect on investment management company profits. Figure 18 shows the responses to Survey Question 12: "Have the new registration and disclosure requirements affected the profits of your investment management company?" Of those who responded, 75.4% indicated that the profits of their investment management company were affected. This is consistent with anecdotal evidence suggesting that it is the investment management company that bears the majority of costs associated with the registration and disclosure requirements.

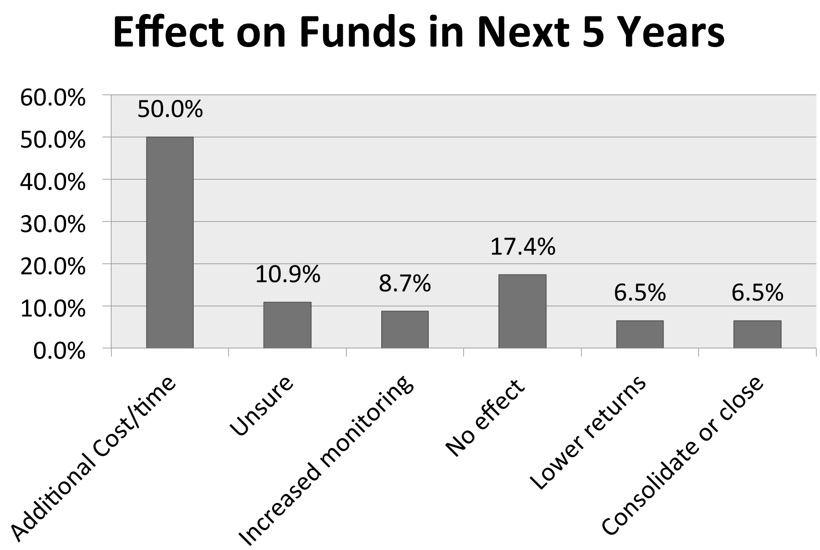


**Figure 19** - How Dodd-Frank Will Affect Fund(s) in the Next Five Years.

Figure 19 shows the respondents' perspectives on the ways Title IV may affect advisers' fund(s) in the next 5 years?" Of those who responded, while 17.4% believed there was no effect and 6.5% suggest the effect is lower returns, 50% indicated that the Dodd-Frank registration and disclosure rules create higher costs that affect their funds.

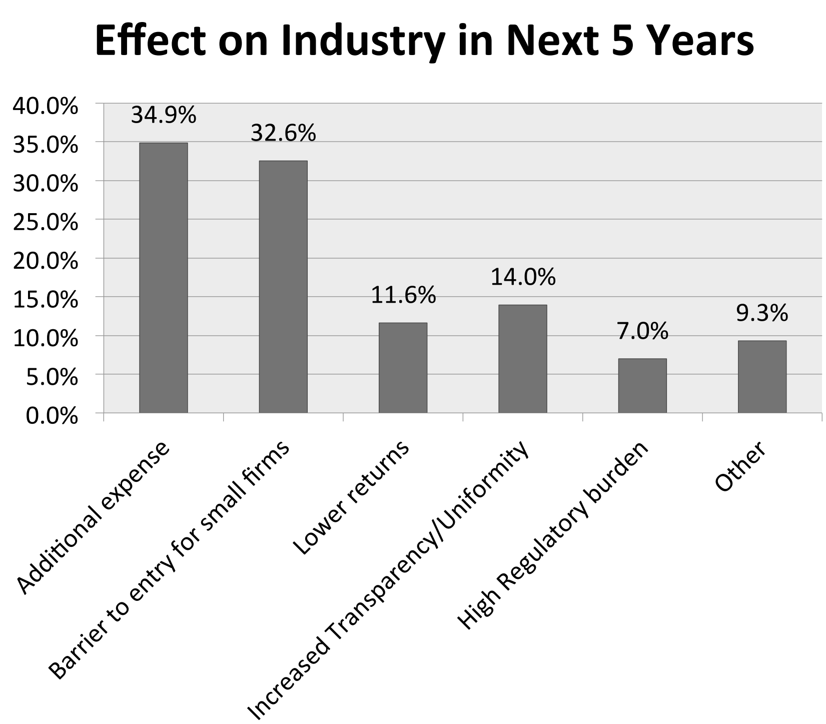

**Figure 20** - How Dodd-Frank Will Affect the Industry in the Next Five Years.

Figure 20 illustrates respondents' views about how Title IV will affect the private fund industry in the next 5 years. The largest numbers of respondents identified additional expenses (34.9%) and barriers to entry (32.6%) for private fund market entrants as likely effects. Given these survey results, it seems possible that the long-term effect of the Dodd-Frank Act on the private investment fund industry is characterized by increasing additional expenses and associated levels of barriers to entry for market entrants.

## V. Discussion and Conclusion

This article helps clarify the relevant long-term implications of the fundamental reshaping of the regulatory landscape for the private fund industry through the Dodd-Frank Act and the JOBS Act. The evidence provided in this long-term study supports findings from earlier studies[70] suggesting that the industry adapted well to the new regulatory environment in the aftermath of the Dodd-Frank Act. Nevertheless, the findings of this study show that the Act has already had some negative effects on the industry and that it may have some negative long-term effects.

### *1. Summary of Key Findings*

The results in several survey question categories suggest that Title IV of the Dodd-Frank Act may have a negative long-term effect on the private fund industry. More than a third of respondents (34.9%) opined that Title IV will affect the private fund industry in the next 5 years because of additional expenses, and more than a third (32.6%) opined that it will create barriers to entry to private fund market entrants. 50% of respondents indicated that the Dodd-Frank registration and disclosure rules have created higher costs that will affect their funds in the next five years. The majority of those respondents who believed that Dodd-Frank has affected their fund(s) earnings blamed additional compliance costs associated with Dodd-Frank. A majority of respondents have instituted measures in response to the requirements imposed by Title IV. The most common actions taken include: (1) outsourcing compliance work, (2) hiring additional counsel, (3) instituting new record-keeping policies, (4) hiring additional staff, (5) changing marketing materials, and (6) changing communications with investors. A majority of respondents stated that as a result of the

[70] Kaal, *supra* note 3.

post Dodd-Frank Act regulatory regime, their AUM would need to change. While 18.2% of respondents would lower their AUM to avoid the regulatory hassle, 27.3% actually still want to increase their AUM. Another 27.3% desire to attain the right size to cover expenses.

Compliance costs are a significant issue for the private fund industry. A majority of respondents found Dodd-Frank compliance costs to range from $50,000 to $200,000. However, a significant minority estimates the total compliance cost will range from $200,000 to over $400,000. A considerable number of respondents estimated the total annual cost to comply with all federal regulations pertaining to the private fund industry at up to $100,000. The largest number of respondents (26.5%), however, estimated the annual compliance cost for all federal regulations at between $100,000 and $200,000. A smaller group (14.3%) estimated the cost of compliance as more than $400,000 a year.

Respondents' estimates pertaining to compliance time are consistent with their estimates pertaining to compliance cost. Although a clear majority of adviser respondents spent fewer than 500 hours to comply with Title IV, a noticeable minority (11.5%) estimated compliance time at more than 1000 hours. 65.1% of respondents estimate the total time required to comply with all federal regulations at between 100 and 500 hours. However, a noticeable minority (20.9%) estimate it above 1000 hours.

The results in several survey question categories suggest that Title IV of the Dodd-Frank Act had a negligible effect on the private fund industry. Most importantly, 65% of private fund adviser respondents believed that their fund earnings were not affected by Title IV, and 75.4% opined that profits were not affected by the increased compliance requirements in Title IV. A majority (74.5%) of private fund adviser respondents do not plan a strategic response to Title IV of the Dodd-Frank Act. A majority of respondents did take the regulatory regime into account before Dodd-Frank, implying that Dodd-Frank did not make much difference in the way respondents run their business. However, of those who responded, 70.60% would not take the current regulatory regime into account in determining the AUM size of their funds. While a majority of respondents (33.3%) prefer an AUM size of between $500 million and $1 billion, no clear majority emerges as to the preference pertaining to the $1.5 billion Form PF quarterly reporting threshold for larger funds. And, a majority of adviser respondents (66.7%) did not take the $1.5 billion AUM threshold under Form PF for quarterly reporting into account in determining the appropriate size of AUM for the fund(s) they manage. While 26.5% of respondents opined that there was no impact on their AUM preference, target investment opportunities and additional expenses did influence respondents' AUM preferences. Moreover, Private fund advisers in the sample did not terminate existing employment relationships. Few respondents severed an advising relationship, changed funds' (legal) structure, liquidated positions, changed investment styles, changed portfolio structure, or closed funds to new investors.

*2. Private Fund Policy and Future Research*

The results reported in this study have implications for private fund policy. Based on the findings in this study, it appears that the SEC's clarifying and optimizing of the legal framework post Dodd-Frank Act effectively supports the industry in its efforts to comply with the revised standards. At the same time, there is sufficient evidence in the findings that the SEC's implementation and clarification of Dodd-Frank Act registration and reporting requirements for private funds also creates uncertainty and higher costs for the industry.

Overall, the private fund industry seems to be adjusting well, and the long-term impact of the evolving post Dodd-Frank Act regulatory landscape appears to be much less intense than the industry initially anticipated. The long-term cost implications of registration and reporting obligations as reported in this study appear to be absorbed relatively quickly after registration. The costs of compliance associated with the Dodd-Frank Act are, depending on size of the investment adviser, largely manageable by the industry.

# VII. APPENDIX: 2015 SURVEY INSTRUMENT

**Survey Questions**

1. Is your investment adviser / fund manager registered with the SEC?

   a. Yes ☐
   b. No ☐

2. Which of the following actions have you taken to assure compliance with Dodd-Frank Act registration and reporting requirements?

   Please check all that apply:

   a. Outsourced compliance work ☐
   b. Hired additional counsel ☐
   c. Instituted new record-keeping policies ☐
   d. Hired additional staff ☐
   e. Fired staff ☐
   f. Severed an advising relationship with client(s) (i.e., closed fund and went private to escape registration and disclosure requirements)☐
   g. Changed marketing materials ☐
   h. Changed communications with investors ☐
   i. Changed fund (legal) structure ☐
   j. Liquidated positions ☐
   k. Changed investment style ☐
   l. Changed portfolio structure ☐
   m. Closed fund(s) to new investors ☐
   n. Other ☐

   ________________________________________________
   ___

3. Do you plan to implement strategic responses to the new registration and disclosure requirements?

   a. No ☐

b. If yes ☐, what strategic responses do you plan to implement?

______________________________________________

4. In what ways will the new registration and disclosure rules affect your fund(s) in the next 5 years?

______________________________________________

5. In what ways will the new registration and disclosure rules affect your industry in the next 5 years?

______________________________________________

6. Please respond to the questions pertaining to the new registration and reporting requirements in each category:

   a. Time:

      i. Compliance with the Dodd-Frank Act reporting requirements will take approximately:

         1. 100 - 250 hours per year ☐
         2. 250 - 500 hours per year ☐
         3. 500 - 750 hours per year ☐
         4. 750 - 1000 hours per year ☐
         5. More than 1000 hours per year ☐
         6. Other ☐

      ii. Compliance with all federal rules and procedures (Treasury, SEC, CFTC etc.) will take approximately:

☐ hours per year

b. Cost (defined as actual expenses incurred):

   i. Compliance with the new reporting requirements will annually cost approximately:

      1. $50,000 - $100,000 ☐
      2. $100,000 – $200,000 ☐
      3. $200,000 – $300,000 ☐
      4. $300,000 – $400,000 ☐
      5. More than $500,000 ☐
      6. Other ☐ ☐

   ii. Compliance with all federal rules and procedures (Treasury, SEC, CFTC etc.) will annually cost approximately:

      $ ☐

7. Would you take the current regulatory regime into account in determining the appropriate size of asset (AUM) for your fund(s)?

   a. No. ☐
   b. If Yes ☐ –

      i. How would you take it into account?

      ______________________________________

      ii. Did you take it into account before the Dodd-Frank Act was enacted?

         a. No. ☐
         b. Yes.☐

8. After the enactment of the Dodd-Frank Act reporting and disclosure requirements, what assets size (AUM) would you desire to operate your fund(s):

a. $150 mil - $500 mil ☐
b. $500 mil - $1 bil ☐
c. $1 bil - $1.5 bil ☐
d. $1.5 bil - $2 bil ☐
e. More than $2 bil ☐
f. Other ☐
g. N/A ☐

9. What affected your response to Item 8?

______________________________________________________

10. Would you take the Form PF threshold for quarterly reporting of $1.5 bil assets (AUM) into account in determining the appropriate size of assets (AUM) for your fund(s)?

a. No ☐
b. If yes ☐, how would you take it into account?

______________________________________________________

11. Have the new registration and disclosure requirements affected your fund's earnings / net rate of return to your investors?

a. No ☐
b. If yes ☐, how?

______________________________________________________

12. Have the new registration and disclosure requirements affected the profits of your investment management company?

    a. No ☐
    b. If yes ☐, how?