HEDGE FUNDS' SYSTEMIC RISK DISCLOSURES IN BANKRUPTCY

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ABSTRACT

Hedge fund advisers' systemic risk disclosure obligations under Title IV of the Dodd-Frank Act and SEC implementation rules may have unanticipated future applications and knock-on effects on other areas of the law and hedge fund practices. Federal Bankruptcy Rule 2019 (Rule 2019) has been the subject of intense professional and scholarly debate in the last several years. The federal bankruptcy bench, practitioners, and academics have debated the importance of the purported purpose of Rule 2019, the necessity for hedge funds to protect trading strategies and proprietary information, and the role of creditors and groups of creditors in the bankruptcy process. This paper adds another element to the debate by evaluating possible implications of systemic risk disclosures by hedge fund managers under Title IV of the Dodd-Frank Act and SEC implementation rules in the bankruptcy context. The author provides evidence of a substantial overlap between systemic risk disclosure requirements under Title IV and the disclosure requirements under the fully-revised version of Bankruptcy Rule 2019 (Revised Rule 2019). In the current regulatory framework, the threat of public disclosure of systemic risk filings by hedge funds via the bankruptcy process may only marginally affect hedge funds' tactics and their role in distressed investing. Hedge funds' disclosure obligations under the Dodd-Frank Act are still rather generic, the SEC has not yet standardized the requirements, and it is unclear if the SEC will expand the systemic risk disclosure obligations for hedge funds investing in distressed securities. The hedge fund industry's continuous, expanding, and increasingly assertive presence in distressed securities investments could change this evaluation in the future.

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INTRODUCTION

Hedge funds' distressed and default debt investments in the United States have increased dramatically in the last two decades (from around $70 billion in 1998 to around $867 billion in 2007).[1] The profitability of several distressed debt "pioneer" funds in the late 1980s and early 1990s precipitated a large following of so-called "pilot fish," i.e., hedge funds that increasingly emulated the strategies of these industry leaders and alleged "sharks." Accordingly, hedge funds with strategies that focus on distressed investing have proliferated. The total assets managed by distressed-focused hedge funds increased from less than $10 billion in 1998 to over $200 billion in 2007.[2] The proliferation of distressed-focused hedge funds resulted in hedge funds' market share of around one quarter of the total distressed-debt market[3] and established the distressed-focused strategy as the fifth-largest hedge fund strategy.

The significant increase of hedge fund participation in the bankruptcy process, among other factors, resulted in an increased emphasis in the literature on the role of hedge funds in bankruptcy. Scholars, practitioners, and members of the federal bankruptcy bench voiced concern over hedge funds' hidden agendas and offsetting positions, hedge funds' attempts to manipulate the negotiation and reorganization process, and their seeking control of the debtor at the expense of other

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[1] *See* EDWARD I. ALTMAN & BRENDA KARLIN, SPECIAL REPORT ON THE INVESTMENT PERFORMANCE AND MARKET DYNAMICS OF DEFAULTED BONDS AND BANK LOANS: 2009 REVIEW AND 2010 OUTLOOK 22 (N.Y.U. Salomon Ctr. Leonard N. Stern Sch. Bus., 2010), *available at* http://people.stern.nyu.edu/ealtman/2009InvestPerf.pdf [hereinafter ALTMAN, 2009 SPECIAL REPORT]; EDWARD I. ALTMAN & BRENDA J. KUEHNE, SPECIAL REPORT ON THE INVESTMENT PERFORMANCE AND MARKET DYNAMICS OF DEFAULTED BONDS AND BANK LOANS: 2011 REVIEW AND 2012 OUTLOOK (N.Y.U. Salomon Ctr. Leonard N. Stern Sch. Bus., 2012), *available at* http://www.stern.nyu.edu/~ealtman/2011InvestPerf.pdf; Adam J. Levitin, *Finding Nemo: Rediscovering the Virtues of Negotiability in the Wake of Enron*, 2007 COLUM. BUS. L. REV. 83, 86 (2007) (stating "the growth of bankruptcy claims trading has been the most important development in corporate reorganizations in the past two decades.").

[2] ALTMAN, 2009 SPECIAL REPORT, *supra* note 1, at 23; Thomas Della Casa, Mark Rechsteiner & Ayako Lehmann, *Hedge Fund Investing in Distressed Securities*, OPALESQUE, Apr. 2008, at 11, *available at* http://www.opalesque.com/files/ManDistressed_investing_Final.pdf.

[3] ALTMAN, 2009 SPECIAL REPORT, *supra* note 1, at 12; Stuart C. Gilson & Sarah Abbott, *Kmart and ESL Investments (B): The Sears Merger*, HARV. BUS. REV., Oct. 2008.

stakeholders.[4] Because of their perceived detrimental impact on the bankruptcy process, some commentators have labeled distressed hedge fund investors as "vultures."[5] Others emphasize the liquidity provided by hedge funds and the corresponding enhancement of the restructuring process.[6]

To address these concerns, an increasingly important part of the literature suggests heightened disclosure requirements for distressed hedge fund investors in the context of their involvement in chapter 11 cases.[7] The disclosure of hedge funds' activities in the bankruptcy context culminated in a debate over the extent of disclosure requirements under Rule 2019.[8] Before 2007, disclosures by informal or "ad hoc" committees in chapter 11 cases under old Rule 2019 were rarely litigated and had not been applied to informal or ad hoc committees or groups.[9] After the much-discussed holdings in the *Northwest Airlines Corp.* bankruptcy proceedings,[10] the assessment of Rule 2019 disclosure requirements changed dramatically. In the debate over the extent of disclosure obligations under old Rule 2019, industry

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[4] *See* Wei Jiang, Kai Li & Wei Wang, *Hedge Funds and Chapter 11*, 67 J. FIN. 513, 532 (2012); Michelle M. Harner, *Activist Distressed Debtholders: The New Barbarians at the Gate?*, 89 WASH. U. L. REV. 155, 155 (2011); Jay Krasoff & John O'Neill, *The Role of Distressed Investing and Hedge Funds in Turnarounds and Buyouts and How This Affects Middle-Market Companies*, 9 J. PRIVATE EQUITY 17, 17–18 (2006); Martin Eisenberg, *When Hedge Funds Invest In Distressed Debt: Beyond the Negative Perception is the Beneficial Role They Play*, 238 N.Y. L.J. 11, 11 (Oct. 15, 2007).

[5] *See* Letter from Hon. Robert E. Gerber to the Advisory Comm. on Bankr. Rules re: FED. R. BANKR. P. 2019 at 2 n.6 (Jan. 9, 2009), *available at* http://html.documation.com/cds/NCBJ2010/PDFs/017_6.pdf [hereinafter Gerber Letter to Advisory Comm.]; Harvey R. Miller, *Chapter 11 Reorganization Cases and the Delaware Myth*, 55 VAND. L. REV. 1987, 2016 (2002) (stating "distressed debt traders may sacrifice the long-term viability of a debtor for the ability to realize substantial and quick returns on their investments."); *see also Rich Pickings*, FUNDWEB, Apr. 3, 2006, http://www.fundweb.co.uk/home/rich-pickings/120260.article ("Vultures are basically value investors, trying to buy an asset for a price well below its intrinsic or fair value.").

[6] Edith S. Hotchkiss & Robert M. Mooradian, *Vulture Investors and the Market for Control of Distressed Firms*, 43 J. FIN. ECON. 401, 404 (1997) (noting managerial skills vulture investors can bring to a firm); *see* Paul M. Goldschmid, *More Phoenix than Vulture: The Case for Distressed Investor Presence in the Bankruptcy Reorganization Process*, 2005 COLUM. BUS. L. REV. 191, 259 (2005) (suggesting distressed debt investors add positive energy to reorganization process).

[7] *See* Frank Partnoy & David Skeel, Jr., *The Promise and Perils of Credit Derivatives*, 75 U. CIN. L. REV. 1019 (2007) (stating disclosure requirements need to be improved); Harner, *supra* note 4, at 194 (suggesting new disclosure requirements); Ralph Brubaker & Charles Jordan Tabb, *Bankruptcy Reorganizations and the Troubling Legacy of Chrysler and GM*, 2010 U. ILL. L. REV. 1375, 1375 (2010) (discussing disclosure requirements in chapter 11 setting); Adam J. Levitin, *Bankruptcy Markets: Making Sense of Claims Trading*, 4 BROOK. J. CORP. FIN. & COMM. L. 67, 110–11 (2009).

[8] *Compare* Levitin, *supra* note 7, *with* Evan D. Flaschen & Kurt A. Mayr, *Bankruptcy Rule 2019 and the Unwarranted Attack on Hedge Funds*, AM. BANKR. INST. J., Sept. 2007, at 16.

[9] *See* Harner, *supra* note 4, at 201 n. 213; *see also* John J. Rapisardi, *Information Disclosure by Distressed Claims Purchasers*, 237 N.Y. L.J. 3, 3, 6 (Mar. 15, 2007) (noting "dearth of case law regarding Rule 2019 exist[ed]" before *Northwest* and *Scotia*); 9 Collier on Bankruptcy, ¶ 2019.04, at 2019-6 (Alan N. Resnick & Henry J. Sommer eds., 15th ed. rev. 2006) ("There is little case law dealing with the requirements for compliance with Rule 2019(a).").

[10] *In re* Nw. Airlines Corp., 363 B.R. 704, 709 (Bankr. S.D.N.Y. 2007) (holding under Rule 2019, members of ad hoc committees must make public disclosure pertaining to claims and interests—disclosures include comprehensive trading history in debtor's securities); *In re* Nw. Airlines Corp., 363 B.R. 701, 702–03 (Bankr. S.D.N.Y. 2007) (requiring firm to include claim information in disclosure statement).

groups such as the Loan Syndications and Trading Association (LSTA) and the Securities Industry and Financial Markets Association (SIFMA) were opposed to any disclosures under old Rule 2019 and called for its repeal.[11] Several academics and the federal bankruptcy bench, represented infamously by Judges Robert E. Gerber and Robert D. Drain (U.S. Bankruptcy Court, S.D.N.Y.), among others, argued for full disclosure by informal or ad hoc committees and groups.[12] In 2011, the Federal Bankruptcy Rules Committee (Rules Committee) put forth a fully-revised version of Bankruptcy Rule 2019 (Revised Rule 2019) for adoption.[13] The revised version of Rule 2019 as proposed by the Rules Committee rejected the industry opposition to the old Rule 2019.

Revised Rule 2019 became effective on December 1, 2011.[14] The Revised Rule seeks to strike a balance by, on the one hand, allowing parties to avoid disclosing price and timing.[15] On the other hand, under Revised Rule 2019 parties acting in concert are required to disclose equity holdings and claims but also any derivative instruments, such as swaps, options, and shorts.[16] Moreover, each time a group files a pleading, derivative parties are required to report material changes in disclosures.[17] The literature discusses if and to what extent groups that negotiated a plan without appearing in court may be able to delay or completely avoid disclosure in the bankruptcy process.[18] Some commentators are concerned that disclosures

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[11] *See* Letter from Elliot Ganz, General Counsel LSTA, to Peter G. McCabe, Secretary, Comm. on Rules of Practice and Procedure of the Judicial Conference of the U.S. on the Testimony of Elliot Ganz Regarding the Proposed Amendment of Fed. Rule of Bankr. Procedure 2019 (January 20, 2010), *available at* http://www.uscourts.gov/uscourts/RulesAndPolicies/rules/2009%20Comments%20Committee%20Folders/BK%20Comments%202009/09-BK-015-Testimony-Ganz.pdf (asserting after holding recognizing ad hoc group of equity holders as committee required to disclose, LSTA and SIFMA argued for repeal of existing Rule 2019).

[12] Hon. Robert D. Drain & Elizabeth J. Schwartz, *Are Bankruptcy Claims Subject to the Federal Securities Laws?*, 10 AM. BANKR. INST. L. REV. 569, 576 (2002) (stating lack of disclosure, which leaves claimants exposed until filing, is undesirable); *see* Gerber Letter to Advisory Comm., *supra* note 5, at 4; Jonathan C. Lipson, *The Shadow Bankruptcy System*, 89 B.U. L. REV. 1609, 1641–42 (2009). *See also* James M. Shea, Jr., *Who is at the Table? Interpreting Disclosure Requirements for Ad Hoc Groups of Institutional Investors under Federal Rule of Bankruptcy Procedure 2019*, 76 FORDHAM L. REV. 2561, 2622 (2008) (describing the history of Rule 2019)

[13] *See generally* FED. R. BANKR. P. 2019; *see also* Memorandum from Hon. Laura Taylor Swain, Chair Advisory Comm. on Bankr. Rules, to Hon. Lee H. Rosenthal, Chair Standing Comm. on Rules of Practice and Procedure, re: the Report of the Advisory Comm. on Bankr. Rules at 3 (May 27, 2010), *available at* http://www.uscourts.gov/uscourts/RulesAndPolicies/rules/Reports/BK05-2010.pdf [hereinafter Report of the Advisory Comm. on Bankr. Rules].

[14] *See Revised Rule 2019 Effective*, MONDAQ, Dec. 15, 2011, http://www.mondaq.com/unitedstates/x/157722/Insolvency,+Administration,+Bankruptcy+and+Liquidation/REVISED+BANKRUPTCY+RULE+2019+EFFECTIVE ("Highly anticipated changes to Rule 2019 of the Federal Rules of Bankruptcy Procedure became effective on December 1, 2011.").

[15] *See* FED. R. BANKR. P. 2019(a)(1) (defining "[d]isclosable economic interest" without including price or timing).

[16] *See* FED. R. BANKR. P. 2019(b) & (c).

[17] *See* FED. R. BANKR. P. 2019(d).

[18] *See New Bankruptcy Rule 2019: Brighter Light, Darker Shadows*, KRAMER LEVIN, June 27, 2011, http://www.kramerlevin.com/Corporate-Restructuring-and-Bankruptcy-Alert-New-Bankruptcy-Rule-2019-Brighter-Light-Darker-Shadows-06-28-2011/.

under Revised Rule 2019 will pertain only to those parties in the bankruptcy process who participate publicly in court or serve on official committees.[19] Disclosures may not apply to parties who merely negotiate a plan.[20] In this line of reasoning, Revised Rule 2019 may not have resulted in an improvement of the bankruptcy process. Rather Revised Rule 2019 may have simply driven parties who would otherwise have participated in the bankruptcy process into the shadows.[21]

Only seven months after the introduction of the Revised Rule 2019, the Securities and Exchange Commission (SEC) promulgated systemic risk disclosure requirements under Title IV of the Dodd-Frank Act. Title IV and SEC rules implementing the requirements under Title IV created a tectonic shift for the regulation of private funds in the United States.[22] Some of the more controversial requirements in Title IV of the Dodd-Frank Act and SEC implementation rules include disclosure obligations that require the reporting of, among other items, risk metrics, performance and changes in performance, positions held by the investment adviser, strategies and products used by the investment adviser and its funds, counterparties and credit exposure, financing information, percentage of assets traded using algorithms, and the percentage of equity and debt.[23] Some studies

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> [N]ew Rule 2019 applies even to groups that stay out of court. Revised Rule 2019(b)(1) requires disclosure by 'every group or committee that consists of or represents, and by every entity that represents' multiple parties acting in concert [emphasis omitted]. In other words, the lawyer who negotiates a plan on behalf of a group of clients, without ever appearing in court, need not file a Rule 2019 statement – but each of his clients, as members of a group, must do so.

Id. See Revised Bankruptcy Rule 2019: New Disclosure Rules Approved, OLSHAN, May 2011, http://www.olshanlaw.com/media/site_files/27_Client_Alert_1105c.pdf.

> Excluded from compliance with revised Bankruptcy Rule 2019 are groups or committees composed entirely of affiliates or insiders of one another and, unless otherwise ordered by the bankruptcy court, indenture trustees, an agent for one or more entities under an agreement for the extension of credit, a class action representative, and certain governmental units. In addition, those groups and committees that do not actually take a position before the bankruptcy court nor solicit votes regarding the confirmation of a plan on behalf of another are not required to comply with the rule.

Id.

[19] *See New Bankruptcy Rule 2019: Brighter Light, Darker Shadows*, *supra* note 18; *Revised Bankruptcy Rule 2019: New Disclosure Rules Approved*, *supra* note 18.

[20] *See New Bankruptcy Rule 2019: Brighter Light, Darker Shadows*, *supra* note 18; *Revised Bankruptcy Rule 2019: New Disclosure Rules Approved*, *supra* note 18.

[21] *See* Lipson, *supra* note 12, at 1651.

[22] Damien Huet, *Dodd-Frank Title IV: Operational Impacts on Hedge Fund and Private Fund Advisers*, OTC CONSEIL AMERICAS, http://www.otc-conseil.com/eng/High/publications/otc-conseil-americas-newsletters/articles-us/6729/dodd-frank-title-iv.pdf (discussing impact of Title IV).

[23] *See* Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF, Release No. IA 3308, (Oct. 31, 2011), *available at* http://www.sec.gov/rules/final/2011/ia-3308.pdf [hereinafter PF Release]; SEC, Form PF, Reporting Form for Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors, *available at* http://www.sec.gov/about/forms/formpf.pdf [hereinafter Form PF]; SEC, Form ADV,

provide evidence that Title IV of Dodd-Frank could change certain practices in the hedge fund industry.[24]

This paper shows that there are significant commonalities between the systemic risk disclosure requirements in Form PF and the disclosure requirements under Revised Rule 2019. Commonalities exist in terms of the scope of required disclosures. For example, where Revised Rule 2019 requires disclosure of all "disclosable economic interests," Form PF similarly requires disclosure and breakdown of regulatory Assets Under Management (AUM), gross and net asset value, the value of the reporting fund's investments in equity of other private funds, and the aggregate gross asset value of the reporting fund's controlled portfolio companies.[25] Similarly, both Revised Rule 2019 and Form PF require disclosure of derivative positions.[26]

Given the hedge fund industry's strong emphasis on secrecy, the threat of public disclosure of hedge funds' systemic risk filings in the bankruptcy process could change distressed investment practices. The threat of disclosure of systemic risk filings in combination with increasing competition in the distressed-debt market could further incentivize hedge fund manager cooperation in the bankruptcy process. In the foreseeable future, standardization of Form PF disclosures could result in fewer generic disclosures that could be increasingly relevant in the bankruptcy context. Moreover, because Revised Rule 2019 may result in less overall disclosure by distressed hedge fund investors during the bankruptcy process,[27] systemic risk disclosures could fill this void with already existing

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Part 1A, Uniform Application for Investment Adviser Registration and Report by Exempt Reporting Advisers, *available at* http://www.sec.gov/about/forms/formadv-part1a.pdf [hereinafter Form ADV, Part 1A].

[24] *See* Wulf A. Kaal, *Hedge Fund Manager Registration Under the Dodd-Frank Act*, 50 SAN DIEGO L. REV. 243, 315 (2013) [hereinafter Kaal, *Manager Registration*] (discussing additional costs and policy changes caused by requirement to file with SEC). The survey data for this study, including the coding sheets are available at: http://wulfkaal.com/data/hedge-fund-registration/. BusinessWeek and several other publications published the results of the study and discussed its implications. *See* Nick Summers, *Who's Afraid of Dodd-Frank? Not Wall Street*, BUS. WK., Oct. 18, 2012, http://www.businessweek.com/articles/2012-10-18/whos-afraid-of-dodd-frank-not-wall-street; Chris Kentouris, *Form PF: Much Ado About Nothing for Regulators?*, ISS-MAG, http://www.iss-mag.com/regulations-and-compliance/form-pf-much-ado-about-nothing-for-regulators; Beverly Chandler, *First Study of Impact of Dodd-Frank Suggests Hedge Funds Are Adapting Well*, OPALESQUE, Oct. 16, 2012, www.opalesque.com/643955/First_study_of_impact_of_suggests_hedge395.html; Ricardo Kaulessar, *Surveys Cover Dodd-Frank, Shareholder Activism, Pension Allocations*, HEDGEFUNDSX, Oct. 18, 2012, http://hedgefundsx.com/uncategorized/surveys-cover-dodd-frank-shareholder-activism-pension-allocations/; *Hedge Funds Taking Dodd-Frank In Stride*, FINALTERNATIVES, Oct. 16, 2012, http://www.finalternatives.com/node/21870.

[25] *See* Form PF, *supra* note 23, at § 1a, item B.3., § 1b, items B.8–B.10., § 4, item B.67.

[26] *See* FED. R. BANKR. P. 2019(a); Form PF, *supra* note 23, at § 1b, item B.13., § 2b, item D.44.

[27] *See* FED. R. BANKR. P. 2019(a) (listing what appointed committee must disclose in chapter 11 reorganization plan); Sparkle L. Alexander, Note, *The Rule 2019 Battle: When Hedge Funds Collide with the Bankruptcy Code*, 73 BROOK. L. REV. 1411, 1439–40 (2008) (explaining that the *Scopac* decision "does not require that each member of an ad hoc committee [to] disclose the information required by Rule 2019. Instead, it allows ad hoc committees to simply file a statement identifying the members of the committee and stating the aggregate claims held by its members.").

disclosures in Form PF.

Systemic risk disclosures in the bankruptcy context could be premature, at least in the short term. The disclosures in Form PF are still much more generic than any disclosures in the bankruptcy context under Revised Rule 2019. The SEC has not yet standardized the required disclosures in Form PF and there is some evidence that the disclosure requirements in Form PF are based on an inconsistent use of industry terms which may in turn result in inconsistent and perhaps contradictory data reporting.[28] Many open issues remain to be evaluated.[29] There is also no indication that the SEC will further increase the systemic risk disclosure obligations for hedge funds investing in distressed securities. Based on these observations, the threat of public disclosure of systemic risk filings by hedge funds via the bankruptcy process may only marginally affect hedge funds' tactics and their role in distressed investing.

This paper is divided into six parts. After this short introduction, Part I outlines the debate on hedge fund disclosures in bankruptcy. Part II provides a short overview of hedge fund adviser registration and enhanced disclosure requirements under Title IV of the Dodd-Frank Act and SEC implementation rules. Part III describes the commonalities between systemic risk disclosures in Form PF and the disclosure requirements under Revised Rule 2019. Part IV discusses the possible benefits and detriments of systemic risk disclosures in the bankruptcy context. The final part concludes.

I. BANKRUPTCY DISCLOSURES

Disclosure obligations in bankruptcy can pertain to all parties who have a stake in the outcome of the restructuring process. Debtors in bankruptcy face extensive disclosure obligations.[30] Unlike debtors, creditors and shareholders are typically not required to disclose their interests until they participate in a bankruptcy case by filing a proof of interest or claim and seek to be heard by a judge.[31] To the extent that creditors and shareholders are required to make disclosures in a bankruptcy case, a general statement regarding the type of claim or interest held by the party can often suffice. As a result, hedge funds' penchant for secrecy outside the bankruptcy context continues even when they participate as debt holders in bankruptcy cases.

Hedge funds' involvement and financial gains in the bankruptcy process have heightened commentators' concerns over this lack of transparency. Hedge funds' alleged hidden agendas in the bankruptcy context and their use of offsetting positions and tactics to benefit from any outcome in bankruptcy proceedings are

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[28] Wulf A. Kaal, *Can FSOC Assess Systemic Risk? – Evidence from Private Fund Data Reporting* (forthcoming 2014) [hereinafter Kaal, *FSOC Systemic Risk*].

[29] *Id.*

[30] *See* FED. R. BANK. P. 2019(a) (listing disclosure requirements).

[31] *See, e.g.*, 11 U.S.C. § 1109 (2012) (listing parties which may be heard in relation to proceeding under chapter 11); FED. R. BANKR. P. 3001 (describing requirements for filing Proof of Claim).

perceived as especially problematic.[32] Transparency concerns have also been raised over hedge funds' alleged attempts to manipulate the negotiation and reorganization process to gain control of the debtor at the expense of other stakeholders.[33]

The concerns over hedge funds' involvement and practices in the bankruptcy process motivated an evaluation of the purported purpose of old Rule 2019 and culminated in a complete revision of the Rule.[34] Revised Rule 2019 governs the disclosure requirements for creditor groups in chapter 9 and chapter 11 cases.[35] Before the rule was revised in 2011, old Rule 2019 required any entity or unofficial committee representing more than one creditor or equity security holder in a bankruptcy proceeding to disclose the name and address of the creditor as well as the nature and amount of the claim and the time of acquisition.[36]

Old Rule 2019 had been applied inconsistently in practice. Courts interpreted old Rule 2019 with a high degree of variability, both across and within jurisdictions. Bankruptcy courts in the Southern District of New York and the District of Delaware applied old Rule 2019 rather broadly, holding that ad hoc committees were subject to old Rule 2019 disclosure requirements;[37] but another bankruptcy court in the District of Delaware issued a contrary opinion, finding that ad-hoc committees and steering groups were not subject to old Rule 2019 disclosure requirements.[38] Courts in the Southern District of Texas and the Eastern District of Pennsylvania also opined that old Rule 2019 did not apply to ad-hoc committees.[39]

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[32] *See* Paul D. Leake & Mark G. Douglas, *Ad Hoc Committee Disclosure Requirements–A Bitter Pill to Swallow for Distressed Investors*, JONES DAY BUS. RESTR. REV., May 2007, at 24, *available at* http://www.jonesday.com/files/Publication/0a396e1a-a5ef-4565-aa63-0ffd9b5e298f/Presentation/PublicationAttachment/430866bd-10b4-4267-9f78-14b09539c6b9/JD_NYI_3996293_1_2019%20Article%20for%20May_June%202007%20BRR.pdf; *see also* Mark Berman & Jo Ann J. Brighton, *Will the Sunlight of Disclosure Chill Hedge Funds?: The Tale of Northwest Airlines*, AM. BANKR. INST. J., May 2007, at 24; Eisenberg, *supra* note 4.

[33] *See generally* Jiang, Li & Wang, *supra* note 4.

[34] *See* Alexander, *supra* note 27, at 1411–13; Shea, *supra* note 12, at 2622.

[35] FED. R. BANKR. P. 2019.

[36] FED. R. BANKR. P. 2019(a) (2010) (amended 2011). The Rule requires a disclosure of:

> (1) the name and address of the creditor or equity security holder; (2) the nature and amount of the claim or interest and the time of acquisition thereof unless it is alleged to have been acquired more than one year prior to the filing of the petition; (3) a recital of the pertinent facts and circumstances in connection with the employment of the entity . . . ; and (4) the amounts of claims or interests owned by the entity, the members of the committee or the indenture trustee, the times when acquired, the amounts paid therefor, and any sales or other disposition thereof.

Id.

[37] *See In re* Wash. Mut., Inc., 419 B.R. 271, 274 (Bankr. D. Del. 2009) (finding ad-hoc committee of noteholders was required to meet Rule 2019 disclosure obligations); *In re* Nw. Airlines Corp., 363 B.R. 701, 703 (Bankr. S.D.N.Y. 2007) (stating ad-hoc committee of equity security holders was required to comply with Rule 2019 disclosures).

[38] *See In re* Premier Int'l Holdings, Inc., 423 B.R. 58, 63 (Bankr. D. Del. 2010) (explaining informal ad hoc committee of bondholders was not required to make Rule 2019 disclosures).

[39] *See In re* Philadelphia Newspapers LLC, 422 B.R. 553, 544 (Bankr. E.D. Pa. 2010) (holding steering group of pre-petition lenders are not subject to Rule 2019 disclosure requirements); Scotia Pacific Company

Courts also differed with respect to the amount of information required to be disclosed under old Rule 2019. While some courts required only the disclosure of the names and addresses of the members of the disclosing group,[40] others demanded more detailed disclosures.[41]

The growing number of conflicting cases and the resulting confusion and uncertainty precipitated a concerted effort by bankruptcy practitioners and the federal bankruptcy bench to revise old Rule 2019. In late 2009, the Committee on Rules of Practice and Procedure of the Judicial Conference of the United States (the Judicial Conference Practice and Procedure Committee) proposed amendments to old Rule 2019.[42] The Committee's initial proposal provided that entities subject to Revised Rule 2019 would be required to disclose the price and date of purchase for each disclosable economic interest.[43] The initial proposal also required a verified statement detailing all disclosable economic interests. The verified statement was to include the name of the members of any entity, committee, or group and the nature and amount of each disclosable economic interest held in relation to the debtor.[44]

LLC Motion for Reconsideration and Clarification of the Court's Order Denying SCOPAC's Motion to Compel the Ad Hock Committee to Fully Comply with Bankruptcy Rule 2019(a) by Filing a Complete and Proper Verified Statement Disclosing its Membership and their Interests at 1, *In re* Scotia Development LLC, 2007 WL 1192137 (Bankr. S.D. Tex. Apr. 20, 2007) (No. 07-20027) (explaining court denied motion and found ad hoc noteholder group was not subject to Rule 2019).

[40] *In re* Scotia Development LLC, No. 07-20027, 2007 WL 1192137 (Bankr. S.D. Tex. Apr. 20, 2007).

[41] *In re* Wash. Mut., Inc., 419 B.R. at 274; *In re* Nw. Airlines Corp., 363 B.R. at 701, 702–03; *In re* Premier Int'l Holdings, Inc., 423 B.R. at 63–64.

[42] *See generally* Hearing on Proposed Amendments to the Federal Rules of Bankruptcy and Criminal Procedure Before the Advisory Comm. on Bankr. Rules, Judicial Comm. of the U.S. (Feb. 5, 2010), *available at* http://www.uscourts.gov/uscourts/RulesAndPolicies/rules/BK_Hearing_Feb_5_2010.pdf [hereinafter Hearing on Proposed Amendments to Rule 2019]; *see* Kate Laughlin & Matt Wirz, *Bankruptcy Rules Committee Rethinks 2019 Pricing Disclosure Amid HF Panic Attack*, FIN. TIMES, Jan 26, 2010, http://www.ft.com/cms/s/2/166ef296-0abb-11df-b35f-00144feabdc0.html#axzz2r8b2Dhxg; *Amended Bankruptcy Rule 2019: Clarity and Confusion?*, LATHAM & WATKINS, Dec. 1, 2011, http://www.lw.com/thoughtLeadership/bankruptcy-procedure-rule-2019-amended-with-new-disclosure-requirement; *Amended Bankruptcy Rule 2019 Is Effective*, SHEARMAN & STERLING, Dec. 21, 2011, http://www.shearman.com/files/Publication/169693fa-16fd-4df9-9910-cc4e95ec34d0/Presentation/PublicationAttachment/edcd2c3e-5019-42ab-ab25-daec7540a9c3/Amended-Bankruptcy-Rule-2019-Is-Effective-BR-122111_%26%25.pdf.

> In response to these inconsistent decisions, in August 2009, the Advisory Committee on Bankruptcy Rules proposed amendments to Rule 2019. This proposed amended rule was commented on by the public, revised in response to such comments, and passed through various committees for approval. Most of the debate surrounding the amendments was focused on disclosure of the date when economic interests were acquired and the amount paid for such interests with many commentators arguing that such information was generally irrelevant to any issue in a chapter 11 case and prone to strategic use.

Id.

[43] *Amended Bankruptcy Rule 2019 Is Effective*, *supra* note 42, at 2–3.

[44] *Id.* at 2. *See also Standing Committee Approves Major Changes to Bankruptcy Disclosure Rule*, DAVIS POLK, June 16, 2010, http://www.davispolk.com/files/Publication/ab3987a9-a349-451e-8495-

The Rules Committee's public hearings on the proposed amendments to old Rule 2019 were rather controversial.[45] Commentators at the hearing were divided into two distinct groups, one motivated by economic interests, the other by the public interest.[46] The Rules Committee ultimately decided to incorporate comments from both camps into Revised Rule 2019.[47]

During the public hearings, hedge funds and private equity investors, industry groups, and other distressed debt investors highlighted the potential consequences of public disclosure of proprietary price information.[48] Industry groups such as the Loan Syndications and Trading Association (LSTA) and the Securities Industry and Financial Markets Association (SIFMA) called for a repeal of old Rule 2019.[49] Hedge funds argued that increased disclosure obligations would disincentivize

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bc7873da2789/Presentation/PublicationAttachment/ed332081-c016-4b89-9071-bcf2f66c6f20/061610_ir_update.pdf.

> Original Proposed Rule 2019 introduced the term 'disclosable economic interest', which detailed numerous broad categories of information that covered parties must disclose. A specific provision also allowed the court, on motion of any party in interest or its own motion, to require disclosure by any entity that seeks or opposes the granting of relief. Representative and represented entities, except for those represented by official committees, were also required to disclose, with respect to each disclosable economic interest: (i) the nature of holdings; (ii) the amount held; (iii) the date acquired; and (iv) if ordered by the court, the prices paid therefor. Original Proposed Rule 2019 also required monthly supplemental statements advising as to material changes in the disclosable economic interests held.

Id. James M. Wilton & James A. Wright III, *Parsing and Complying with New Rule 2019*, AM. BANKR. INST. J., Oct. 2011, at 16.

> Central to the disclosure requirement is the new concept of a 'disclosable economic interest.' This defined term includes not only claims against and equity interests in a debtor, but also options, participations, pledges and liens, and derivative instruments or other rights in relation to the debtor, that are 'affected by the value, acquisition or disposition of a claim or interest.

Id.

[45] *See* Ronit Berkovich & Sara Coelho, *To Disclose or Not To Disclose: The Latest In the Controversy Over What Bankruptcy Rule 2019 Should Require*, WEIL BRIEFING: BUSINESS FINANCE AND RESTRUCTURING, June14, 2010, http://www.weil.com/news/pubdetail.aspx?pub=9836.

[46] *Id.*

[47] *See generally* Hearing on Proposed Amendments to Rule 2019, *supra* note 42; Report of the Advisory Comm. on Bankr. Rules, *supra* note 13.

[48] Jennifer Albrecht, *New Bankruptcy Rule 2019: Boon or Bane for Distressed Investors?*, 2011 COLUM. BUS. L. REV. 717, 733–34 (2011); Nicholas F. Kajon, *Northwest Rulings May Chill Hedge Fund Participations in Chapter 11 Cases*, STEVENS & LEE, Mar. 16, 2007, http://www.stevenslee.com/news/bankruptcy/Northwest_Ruling_ 0307.pdf; Michael DeMarino, *Rule 2019: The Debtor's New Weapon*, 42 J. MARSHALL L. REV. 165, 181 (2008); Flaschen & Mayr, *supra* note 8, at 47.

[49] *See* Letter from the Sec. Indus. & Fin. Mkts. Ass'n and the Loan Syndications & Trading Ass'n, to Peter McCabe, Secretary, Comm. on Rules of Practice & Procedure of the Judicial Conf. of the U.S. (Nov. 30, 2007), *available at* http://www.uscourts.gov/uscourts/RulesAndPolicies/rules/BK%20Suggestions%202007/07-BK-G-.pdf; *Ad Hoc Committee Disclosure Requirements*, *supra* note 32; Albrecht, *supra* note 48, at 733–34.

participation in ad-hoc groups.[50] A major concern voiced in this context was the possibility of reverse engineering of hedge funds' investment strategies and the increase in the "pilot fish" phenomenon that could force distressed debt investors out of the market for distressed securities, leading to less liquidity.[51] Others argued that price information pertaining to distressed investments would better be obtained through the application of Bankruptcy Rule 2004.[52]

Commentators who were largely motivated by the public interest and judicial economy, including the federal bankruptcy bench argued for full disclosure by informal or ad hoc committees and groups under old Rule 2019.[53] Their primary motivation to support an amendment of old Rule 2019 pertained to the alleged misappropriation of the bankruptcy process for the financial gain of only one constituent in the bankruptcy process.[54] Another argument for reform of old Rule 2019 in this context was the purpose and efficient functioning of the bankruptcy process.[55]

After a lengthy and controversial drafting process, Congress approved Revised

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[50] Richard D. Thomas, *Tipping the Scales in Chapter 11: How Distressed Debt Investors Decrease Debtor Leverage and the Efficacy of Business Reorganization*, 27 EMORY BANKR. DEV. J. 213, 233 (2010).

[51] *See* Dale B. Thompson, *Why We Need a Superfund for Hedge Funds*, 79 MISS. L.J. 995, 1033 (2010); *Hedge Fund Industry Concerned about Scope of SEC's Audit Trail Rule Proposal*, 4 HEDGE FUNDS & PRIVATE EQUITY, Aug. 20, 2010; David Edwards, *Reverse Engineer Your Mutual Fund*, THE STREET.COM, May 6, 2002, http://www.thestreet.com/funds/mutualfundmondaydedwards/10020715.html (discussing how to reverse-engineer a mutual fund). *See also* Letter from Loan Syndications & Trading Ass'n & Sec. Indus. & Fin. Mkts. Ass'n to Comm. on Rules of Practice and Procedure of the Judicial Conference of the United States, at 12 (Feb. 1, 2010), *available at* http://www.lsta.org/WorkArea/showcontent.aspx?id=8978.

[52] Richard J. Corbi, Billy Hildbold & Jonathan M. Petts, *New Rule 2019: Distressed Investors, What Are You Holding?*, AM. BANKR. INST. J., June 2011, at 77 ("Thus, disclosure of the purchase prices and specific trading information of *ad-hoc* committee members may be still be ordered by a court pursuant to its inherent powers or obtained by other discovery means such as Rule 2004 in certain cases."); Glenn E. Siegel, James O. Moore & Janet M. Bollinger, *The Trend Towards Greater Disclosure of Bondholder Positions in Bankruptcy - The Advisory Committee on the Federal Rules of Bankruptcy Procedure Proposes a Substantial Rewrite of Federal Rule of Bankruptcy Procedure 2019*, J. BANKR. L., July/Aug. 2010, at 401.

> Furthermore, if there were certain situations where pricing was relevant, LSTA and SIFMA argued the discovery process or Bankruptcy Rule 2004 examinations are sufficient to uncover the necessary information. LSTA and SIFMA supported a revised version of Proposed Rule 2019 that removes the provisions addressing the disclosure of amount paid and date acquired.

Id.

[53] *See* Hearing on Proposed Amendments to Rule 2019, *supra* note 42, at 5, 34, 62; Report of the Advisory Comm. on Bankr. Rules, *supra* note 13, at 6; Shea, *supra* note 12, 2621. *See also* Evan D. Flaschen and Kurt A. Mayr, *Ad Hoc Committees and the Misuse of Bankruptcy Rule 2019*, 16 NORTON J. BANKR. L. & PRAC. 983, 996–97 (2007); Kathy L. Yeatter, *Controversial Disclosure Requirements Under Proposed New Version of Bankruptcy Rule 2019*, AM. BANKR. INST. J., Mar. 2010, at 24.

[54] *See* Hearing on Proposed Amendments to Rule 2019, *supra* note 42, at 34 (statement of general counsel of the Loan Syndications and Trading Association, requesting court to require each holder in group to disclose their economic interest).

[55] *Id.* at 42 (statement of Forest Wolfe, the deputy general counsel at Angelo, Gordon, stating that multiple creditors being represented by same counsel allows for a more efficient proceedings).

Rule 2019, which became effective on December 1, 2011.[56] While Revised Rule 2019 clarifies some of the ambiguities under old Rule 2019, uncertainty and confusion still seem inevitable. For instance, the scope of Revised Rule 2019 is broader than the scope of the old Rule because it requires disclosure from committees, entities, and groups that are "acting in concert to advance their common interests," and are "not composed entirely of affiliates or insiders of one another."[57] However, there is still substantial uncertainty as to what entities and individuals may be covered by Revised Rule 2019.[58]

The definitions under Revised Rule 2019 exemplify the potential for uncertainty and confusion. Revised Rule 2019 defines the terms "represents" and "disclosable economic interest" broadly.[59] While the new definition of "represents" clarifies that active participation in a bankruptcy case is a prerequisite for representation under Revised Rule 2019, it is unclear if attorneys who merely monitor a bankruptcy case on behalf of a client but do not solicit or advocate a position before the bankruptcy court "represent" their respective clients under Revised Rule 2019. It is also unclear if "represents" includes affiliates' actions and the actions of subsidiaries and thus whether their parent entities will be required to make disclosures under Revised Rule 2019.[60]

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[56] *See generally* FED. R. BANKR. P. 2019; *see Clarity and Confusion?*, *supra* note 42 ("On April 26, 2011, the Supreme Court of the United States adopted amendments to Rule 2019 of the Federal Rules of Bankruptcy Procedure (Amended Rule 2019) and submitted the proposed amendment to Congress for approval. Amended Rule 2019 was approved by Congress and became effective on December 1, 2011.").

[57] FED. R. BANKR. P. 2019(b)(1).

[58] George Mesires, *Continued Uncertainty Over Rule 2019 May Chill Participation of Distressed Investors*, 29 AM. BANKR. INST. J. 1 (2010); Elena Gonzalez, *To Credit Bid or Not to Credit Bid? Creditors May No Longer Get to Ask*, 16 BANKR. LITIG. 16 (2010); Robbin L. Itkin, Katherine C. Piper & Spencer Burrows, *What to Disclose and What Not to Disclose: The Changing Requirements of Rule 2019 of the Federal Rules of Bankruptcy Procedure*, 18 ANN. SW. BANKR. CONF. 683, 684–85 (2010); Gary Kaplan & Jennifer Rodburg, *Rule 2019 Amendments Clarify Disclosure Requirements*, N.Y. L.J., Sept. 26, 2011, ("Amended Rule 2019 expressly exempts from its disclosure requirements indenture trustees, agents for one or more other entities under an agreement for the extension of credit (such as agent banks), class action representatives, and most governmental units, unless the court orders otherwise.").

[59] FED. R. BANKR. P. 2019 (a)(1) & (2) (listing varying various types of claims which can be considered "disclosable economic interest," and defining "represents" as taking position before court or to solicit votes regarding confirmation of a plan on behalf of another).

[60] *See Clarity and Confusion?*, *supra* note 42.

> The amended rule also seeks to clarify certain ambiguities surrounding its scope by adding the defined terms "disclosable economic interest" and "represents" . . . .
>
> The definition of "represents" clarifies that representation requires active participation in the case or in a proceeding on behalf of another entity—either by taking a position on a matter before the court or by soliciting votes on the confirmation of a plan. An attorney who is retained by several creditors or equity security holders to monitor a case, but who does not advocate any position before the court or engage in solicitation activities, does not represent his or her clients for purposes of Rule 2019 and, thus, would not have to make Rule 2019 disclosures.

Id.; Jeffrey N. Rich & Eunice Rim Hudson, *Disclosure Under Amended Bankruptcy Rule 2019*, 14 ANN. N.Y.C. BANKR. CONF. 535, 537 (2012).

An important part of the compromise reached in Revised Rule 2019 pertains to the price and date of disclosable economic interests. Revised Rule 2019 does not require parties to disclose the price and the date of acquisition of such interests, which is exactly what the hedge fund industry lobbied for.[61] However, the Rules Committee notes "Although the rule no longer requires the disclosure of the precise date of acquisition or the amount paid for disclosable economic interests, nothing in this rule precludes either the discovery of that information or its disclosure when ordered by the court pursuant to authority outside this rule."[62]

Given these shortcomings and the corresponding uncertainties, it remains unclear how groups may be able to completely avoid any disclosures under Revised Rule 2019 by simply negotiating a plan without appearing in court.[63] Should Revised Rule 2019 in effect only apply to parties in the bankruptcy process who participate publicly in court or serve on official committees, Revised Rule 2019 may have lowered the overall effectiveness of disclosures in the bankruptcy process. It may simply have driven parties who would otherwise have participated

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> [F]uture litigation with respect to New Rule 2019 will likely involve whether: (1) an entity "represents" multiple creditors or equity security holders and (2) the creditors or equity security holders making up such representative entity are "acting in concert" to fall within the ambit of New Rule 2019. To "represent" creditors or equity shareholders for purposes of New Rule 2019, the group, committee or entity must "take a position before the court" or "solicit votes regarding the confirmation of a plan on behalf of another." *Active* participation in the case, or in a proceeding, on behalf of creditors or equity holders seems to be required for a representative entity to fall within the rule's domain.

Id. Samuel M. Kidder, *What's Your Position? Amending the Bankruptcy Disclosure Rules to Keep Pace With Financial Innovation*, 58 UCLA L. REV. 803, 833–49 (2011); Wilton & Wright III, *supra* note 44; Flaschen & Mayr, *supra* note 53, at 989, 992–93.

[61] *See* Hearing on Proposed Amendments to Rule 2019, *supra* note 42, at 6 (showing that RK&O requested that proposed amendment to Rule 2019 not require disclosure of amount paid and date of purchase on secondary market).

[62] FED. R. BANKR. P. 2019 advisory committee's note.

[63] *See, e.g.*, *Clarity and Confusion?*, *supra* note 42 ("The net effect is that, unlike entities, groups or committees may have to make Rule 2019 disclosures regardless of whether they appear before the court or actively engage in the plan solicitation process."); Sara Coelho, *It's Here! The New Rule 2019 Arrives*, WEIL BANKRUPTCY BLOG, Nov. 30, 2011, http://business-finance-restructuring.weil.com/rule-amendments/it%E2%80%99s-here-the-new-rule-2019-arrives/.

> Notably, the rule does not require a group to take positions in court before the disclosure requirement is triggered. All that is required is that the members be "acting in concert to advance their common interests, and . . . not composed entirely of affiliates or insiders of one another." Accordingly, there is bound to be argument over what constitutes "acting in concert," particularly in early phases of a case where creditors begin negotiating and coordinating with each other, but have not agreed on positions or strategy, or taken any action in the court. Creditors are also likely to be very careful about how they coordinate and communicate to avoid coming under the rule for as long as possible.

Id.

in the bankruptcy process into the shadows.[64] Should this analysis be supported by additional evidence in the coming years, perhaps other disclosure alternatives will be more seriously considered in the bankruptcy process.

II. SYSTEMIC RISK DISCLOSURES

Hedge funds' systemic risk disclosure requirements developed independently from any disclosure requirements in the bankruptcy context. For more than thirty years, disclosure requirements have been a source of controversy between the hedge fund industry and regulators. The SEC attempted to increase the regulatory oversight of the hedge fund industry on several occasions.[65] Finally, in an attempt to close regulatory gaps and end the speculative trading practices that contributed to the 2008 financial market crisis,[66] Congress enacted the Private Fund Investment Advisers Registration Act of 2010 in Title IV of the Dodd-Frank Act (PFIARA or Title IV).[67] The Act and SEC implementation rules established rules and procedures for the registration of private funds and the disclosure of certain proprietary information to the SEC.[68]

The enactment of Title IV was divisive. The Treasury Department favored the enactment of Title IV to facilitate strong oversight of critical financial institutions.[69] Rep. Paul E. Kanjorski (D-PA) (2009, H14420), reflected this view when he stated: "[F]or the first time regulators will have the information needed to better understand exactly how these entities operate and whether their actions pose a threat to the financial system as a whole."[70] The SEC also supported the enactment to increase its understanding of the hedge fund market including the type of risk-taking in that market, the types of securities involved, and the total dollar amount at stake.[71] On the other hand, industry representatives were concerned that Title IV could

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[64] *See* Lipson, *supra* note 12, at 1640–42.

[65] Wulf A. Kaal, *Hedge Fund Valuation: Retailization, Regulation, and Investor Suitability*, 28 REV. BANKING & FIN. L. 581, 601–08 (2009) [hereinafter Kaal, *Valuation*].

[66] *See* Tom Braithwaite, *U.S. Senate Passes Financial Reform*, FIN. TIMES, July 16, 2010, http://www.ft.com/intl/cms/s/0/6b9d4542-9026-11df-ad26-00144feab49a.html#axzz2rSMSDMYZ ("The financial reform legislation approved by the Congress today represents a welcome and far-reaching step toward preventing a replay of the recent financial crisis.") (quoting Ben Bernanke).

[67] *See* Private Fund Investment Advisers Registration Act of 2010, Pub. L. No. 111-203, 124 Stat. 1570, §§ 401-16 (2010) (codified at 15 U.S.C. §§ 80b-2, 80b-3, 80b-4, 80b-10, 80b-11, 80b-18, 80b-20 (2012)).

[68] *See* 15 U.S.C. § 80b-4(b)(1)(A) (2012).

[69] DEP'T OF THE TREASURY, FINANCIAL REGULATORY REFORM, A NEW FOUNDATION: REBUILDING FINANCIAL SUPERVISION AND REGULATION (2009), *available at* http://www.treasury.gov/initiatives/Documents/FinalReport_web.pdf.

[70] 155 CONG. REC. H14420 (daily ed. Dec. 9, 2009) (statement of Rep. Paul Kanjorski).

[71] Zachary A. Goldfarb & David Cho, *Hedge Funds Making Way for Government Regulation*, WASH. POST, Mar. 14, 2009, http://www.washingtonpost.com/wp-dyn/content/article/2009/03/13/AR2009031303063.html ("We're totally unable to discern what's going [on] in . . . [the hedge fund] market[, we] have no idea how many dollars are involved, . . . what type of risk-taking is happening, [we] don't know if they're investing in vanilla securities or investing in the riskiest instruments.") (internal quotations omitted) (quoting SEC Commissioner Luis A. Aguilar).

unnecessarily burden investment advisers and invade clients' secrecy.[72] Legislators opposing Title IV predicted that the enactment would promote unaccountable and unrestrained regulatory agencies.[73]

Title IV requires hedge fund adviser registration to increase record-keeping and disclosure.[74] Hedge fund advisers with more than $150 AUM must register as investment advisers and disclose information about their trades and portfolios to the SEC.[75] Title IV also directs the SEC to establish rules for the registration and reporting of hedge fund managers who had previously been exempt from registration.[76] The registration and supervision of private fund advisers may enable the SEC to collect adequate information to prevent fraud, limit systemic risk, limit the activities of those who operate in the "shadows of our markets"[77] and provide information to investors.[78]

Registered investment advisers must also maintain records and any other information that the SEC and the Financial Stability Oversight Council (FSOC)

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[72] *See* Jenny Strasburg, *Legislators Seek Hedge-Fund Disclosure*, WALL ST. J. (Asia ed.), Feb. 2, 2009, http://online.wsj.com/news/articles/SB123353873110737937?KEYWORDS=Jenny+Strasburg&COLLECTION=wsjie/6month.

[73] *See* Mike Ferullo, R. Christian Bruce, Richard Hill & Malini Manickavasgam, *Senate Sends Regulatory Reform Bill to White House for President's Signature*, 42 Sec. Reg. & L. Rep. 1353 (July 19, 2010) (quoting Banking Committee member Richard Shelby (R-Ala.)).

[74] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 408, 124 Stat. 1376, (2010) (codified at 15 U.S.C. § 80b-3(m) (2012)) ("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.").

[75] *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 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 (eliminating 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 Advisers Act Release No. 3221, 17 C.F.R. pts. 275 and 279 (2011) [hereinafter IAA Release No. 3221] ("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."); SEC, Uniform Application For Investment Adviser Registration and Report Form By Exempt Reporting Advisers (Form ADV) (Sept. 2011), instruction 5, *available at* http://www.sec.gov/about/forms/formadv-instructions.pdf [hereinafter Form ADV, General Instructions] (explaining how to calculate regulatory assets under management); Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers, 17 C.F.R. pt. 275 (2011) [hereinafter IA Release No. 3222] (providing an exemption from registration for advisers with less than $150 million in private fund assets under management in the United States); Form ADV, Part 1A, *supra* note 23, at items 2B, questions 1 & 2 (requiring an exempt reporting adviser to check that he qualifies for an exemption from registration (i) as an adviser solely to one or more venture capital funds; and/or (ii) because it acts solely as an adviser to private funds and has assets under management in the United States of less than $150 million).

[76] Investment Advisers Act of 1940, Pub. L. No. 112-90, § 203, 54 Stat. 847 (codified as amended at 15 U.S.C. §§ 80b-1-80b-20 (2012)).

[77] 155 CONG. REC. H14418, H14420 (daily ed. Dec. 9, 2009) (statement of Rep. Paul Kanjorski).

[78] 156 CONG. REC. S5912, S5913 (daily ed. July 15, 2010) (statement of Sen. Leahy).

deem necessary and appropriate to avoid systemic risk.[79] Investment advisers must provide reports with respect to certain information related to systemic risk,[80] such as trading practices, trading and investment positions, the amount of AUM, valuation policies, side letters, the use of leverage, including off-balance sheet leverage, counterparty credit risk exposures, and other information deemed necessary.[81] These reports are confidential and not publicly available.

Legislators disagreed on the scope of the rules during the drafting process. Legislators supporting the enactment of Title IV wanted the SEC to be able to obtain enough information to prevent fraud, protect against systemic risk, and provide investors with useful information about the funds, even funds that are exempt from registration.[82] Other representatives supporting Title IV argued that years without regulation ushered in the financial crisis,[83] and some expressed concern that the exemptions in Title IV could make the regulation of hedge funds less effective.[84] On the other hand, legislators opposed to the enactment of Title IV alleged that the SEC did not adequately supervise hedge funds under the existing rules.[85] They also contended that hedge funds played no significant role in the financial crisis, that they did not create systemic risk, and that they were irrelevant to the financial system as a whole.[86]

A. Registration

The registration of hedge fund advisers under Title IV facilitates enhanced disclosure and the collection of additional data.[87] The AUM threshold for private

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[79] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act §§ 404, 405.

[80] *See id.* at § 404(b)(3).

[81] *See id.* at § 404(b)(3)(H).

[82] *Compare* 156 CONG. REC. S5912, S5913 (daily ed. July 15, 2010) (statement of Sen. Leahy) (supporting hedge fund manager registration requirement in Dodd–Frank), *with* 156 CONG. REC. S5875–78 (statement of Sen. Richard Shelby) [hereinafter Shelby Statement] (questioning effectiveness of Dodd-Frank Act for reducing systemic risk and criticizing its reliance on massive bureaucracy).

[83] *See* 156 CONG. REC. H14413 (statement of Rep. Frank); 156 156 CONG. REC. H14418 (statement of Rep. Waxman).

[84] *See* 156 CONG. REC. H5235, H5235–39 (daily ed. June 30, 2010) (statement of Rep. Kanjorski) [hereinafter Kanjorski Statement] (outlining concerns with several of the exemptions).

[85] *See* 156 CONG. REC. H5235–36.

[86] *See* Shelby Statement, *supra* note 82, at S5876.

> [T]he bill gives the Securities Exchange Commission . . . a new systemic risk mandate to oversee advisers to hedge funds and private equity funds. Yet no one contends private funds were a cause of the recent crisis or that the demise of any private fund during the crisis resulted in a system-wide shock.

Id.

[87] The registration rules address Dodd-Frank's exemptions from registration enacted in connection with its repeal of Section 203(b)(3) of the Advisers Act; they delegate responsibility for mid-sized investment advisers to state regulatory authorities rather than the SEC, and include amendments to Form ADV implemented by the SEC to reflect the new registration requirements under the Dodd-Frank Act.

fund adviser registration under Title IV is $150 million.[88] Several fund adviser categories are excluded from mandatory registration under Title IV. Excluded advisers include (i) private fund advisers with less than $150 million AUM,[89] (ii) advisers with less than $100 million AUM who provide advice to clients on investments other than private funds,[90] (iii) venture capital fund advisers,[91] and (iv) foreign private advisers with fewer than fifteen clients and investors in the United States.[92] Nevertheless, investment advisers with less than $150 million AUM are required to maintain records and provide annual reports or any other reports that the SEC deems appropriate or necessary to protect investors.[93] Title IV requires the SEC to examine factors including the governance of an investment adviser, its investment strategy, and its size to determine the systemic risk posed by hedge funds and to impose registration and examination procedures accordingly.[94] The SEC has rulemaking authority under Title IV to prevent the registration exemptions from "swallowing the rules."[95]

Investment advisers use Form ADV to register with both the SEC and state securities authorities.[96] Form ADV has two parts. In Part 1 investment advisers disclose information about their clients, employees, business practices, ownership, affiliations, and any disciplinary events.[97] Part 1 helps the SEC process and coordinate registrations and manage its regulatory and examination programs.[98] In Part 2 investment advisers provide a narrative brochure written in plain English.[99] The brochure is the primary disclosure document for investment advisers' clients.

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[88] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 408, 124 Stat. 1575, (2010) (codified at 15 U.S.C. § 80b-3(m) (2012))

[89] *Id.*

[90] *Id.* at § 410 (codified at 15 U.S.C. § 80b-3a(a) (2012)).

[91] *Id.* at § 407 (codified at 15 U.S.C. § 80b-3(l) (2012)).

[92] *See id.* at §§ 402–403 (codified at 15 U.S.C. §§ 80b-2, 80b-3(b) 2012) (stating in order to qualify for exemption, foreign private advisers cannot have a place of business in 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* § 402(a) (codified at 15 U.S.C. § 80b-2(a) (2012)) (allowing the SEC to exercise its rule-making powers and raise this amount).

[93] *See id.* at § 408 (codified at 15 U.S.C. § 80b-3(m) (2012)).

[94] *See id.*

[95] Kanjorski Statement, *supra* note 84, at H5238.

[96] *See* Form ADV, Part 1A, *supra* note 23. *See also* 17 C.F.R. § 279.1 (2013) (establishing filing requirements for FORM ADV); Marybeth Sorady et al., *Summary and Analysis of Dodd-Frank Rules for Investment Advisers: Registration Requirements, Exemptions, Family Offices, Performance Fee Eligibility*, 12 J. INVESTMENT COMPLIANCE 4, 10–11, 15 (2011) (explaining SEC rules under provisions of Dodd-Frank Wall Street Reform and Consumer Protection Act relating to increased asset threshold for federal registration as an investment adviser and analyzing impact of Rules on US and non-US advisers to private funds); James F. Koehler & P. Wesley Lambert, *Impact of the Dodd-Frank and Registration Acts of 2010 on Investment* Advisers, 13 DUQ. BUS. L.J. 29, 35 (2011); Michael P. Coakley & Matthew P. Allen, *The New Form ADV Part 2 and the "Plain English" Movement of the SEC, FINRA and Michigan's OFIR*, 31 MICH. BUS. L.J. 19 (2011).

[97] Form ADV, Part 1A, *supra* note 23.

[98] *See id.*

[99] *See* Form ADV, Part 2, Uniform Application for Investment Adviser Registration and Report by Exempt Reporting Advisers, *available at* http://www.sec.gov/about/forms/formadv-part2.pdf [hereinafter Form ADV, Part 2].

The information in the brochure includes the educational and business background of the adviser's managers and key advisory personnel, the types of advisory services offered, conflicts of interest, the adviser's fee schedule, and disciplinary information.[100]

Conflicts of interest in transactions between advisers or related persons and clients are a major concern for the SEC. To avoid potential conflicts of interest between the different types of advisers' businesses and services, investment advisers are required to disclose their transactions,[101] including their business activity[102] if one of the businesses is primary to the adviser,[103] and whether the adviser provides services other than investment advice to advisory clients.[104] Other disclosures in this context include related-persons status of brokers and dealers,[105] compensation for client referrals,[106] and soft dollar benefits, i.e. research or other products and services in connection with client transactions.[107]

To reflect the new registration requirements under Title IV, the SEC amended Form ADV.[108] Even investment advisers that had previously been registered with the SEC on January 1, 2012 had to file Amended Form ADV by March 30, 2012.[109]

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[100] *See id.* at Items 4–9.

[101] IAA Release No. 3221, *supra* note 75, at 77–78; Form ADV, Part 1A, *supra* note 23, at item 8.A. (requiring disclosure as to whether adviser or related person buys securities from or sells securities to advisory clients, buys securities for himself that he also recommends to advisory clients, or recommends securities to advisory clients in which adviser or related person has proprietary interest (ownership) other than two described immediately above); *id.* at item 8.B. (requiring disclosure as to whether adviser or related person acts as broker-dealer or broker-dealer's representative and executes trades for brokerage customers in which "advisory client securities are sold to or bought from brokerage customer[s]" and whether adviser or related person recommends to his advisory clients the purchase of securities for which the adviser or related person is an underwriter, general or managing partner, or purchaser representative); *id.* at item 8.C. (requiring disclosure as to whether the adviser or related person has discretionary authority to determine what securities should be sold on a client's account and the amount of securities to be sold on that account, to determine the broker or dealer to be used for purchases or sales for a client's account, or to determine commission rates to be paid to a broker or dealer for a client's account).

[102] *Id.* at item 6.A. (providing business activities include broker-dealer, futures commission merchant, real estate broker, banking, legal work, or accounting).

[103] *Id.* at item 6.B.(1) & (2).

[104] *Id.* at item 6.B.(3) (asking adviser to describe other products and services).

[105] *Id.* at items 8.D., 8.F.

[106] *Id.* at items 8.H., 8.I.; *see* IAA Release No. 3221, *supra* note 75, at 77 (adopting three amendments to Item 8: (1) An adviser who indicates he has discretionary authority to determine brokers or dealers or recommends brokers or dealers must report whether any of those brokers or dealers are related persons; (2) Advisers receiving soft dollar benefits must report whether they are eligible for research or brokerage services under § 28(e) of the Exchange Act's safe harbor; and (3) an adviser must report whether it or its related person receives direct or indirect compensation for client referrals); *see* Form ADV, Part 1A, *supra* note 23, items 8.C.(3), 8.E., 8.D., 8.F., 8.G.(2); Commission Guidance Regarding Client Commission Practices under Section 28(e) of the Securities Exchange Act of 1934, Exchange Act Release No. 34-54165, 88 SEC Docket 1372 (July 18, 2006) (providing interpretive guidance in determining whether soft dollar benefits fit under the safe harbor of § 28(e) of the Exchange Act).

[107] Form ADV, Part 1A, *supra* note 23, item 8.G.

[108] *See* IAA Release No. 3221, *supra* note 75, at 16–17 (indicating the SEC is adopting several amendments to the Form ADV "in response to the enactment of the Dodd-Frank Act.").

[109] *See* 17 C.F.R. § 275.203A–5(b) (2013); *see also* IAA Release No. 3221, *supra* note 75, at 10–12 (discussing Rule 203A-5(b), which provides SEC-registered advisers who are not required to file annual

Amended Form ADV requires both registered investment advisers and exempt reporting advisers[110] to file reports with the SEC pertaining to the private funds they manage.[111] Amended Form ADV increases the mandated disclosures and includes several controversial disclosure items[112] regarding (i) the fund structure and ownership, (ii) the fund's investment strategy, (iii) its gross asset value, (iv) the fund's use of consultants and other gatekeepers, (v) the scope of services provided,[113] (vi) the percentage of AUM attributable to each client type,[114] and (vii) the number of employees.[115] Investment advisers must specifically disclose how many employees are registered representatives of broker-dealers, how many employees perform advisory functions, how many employees are registered with state authorities as investment adviser representatives, how many employees are insurance agents,[116] and how many non-employees solicit advisory clients on the adviser's behalf.[117]

Investment advisers' AUM determines the registration status of advisers.[118] Amended Form ADV requires investment advisers to report gross Regulatory Assets Under Management (RAUM), rather than net.[119] RAUM is defined under the Advisers Act as "the 'securities portfolios' with respect to which an adviser provides 'continuous and regular supervisory or management services.'"[120] Reporting net RAUM means advisers will no longer be able to deduct accrued but unpaid

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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 items required to be updated in a typical other-than-annual amendment)).

[110] *See* Form ADV, Part 1A, *supra* note 23, at item 2.B. (requiring exempt reporting advisers to disclose only limited subset of items on Form ADV).

[111] *Id.* at item 2.B.(2)–(3) (asking specifically about private funds).

[112] *See* IAA Release No. 3221, *supra* note 75, at 56–57 (requiring advisers to complete sec. 7.B.(1) of Schedule D for *any* private fund adviser manages when, previously, item 7 required advisers *only* to complete sec. 7.B.(1) of Schedule D for "investment-related" limited partnerships or limited liability companies adviser or related person advised). Part A of sec. 7.B.(1) "requires an adviser to provide basic information regarding the size and organizational, operational, and investment characteristics of each fund." *Id*. at 56. Part B of the same section "requires information about five types of private fund service providers that perform important roles as 'gatekeepers'" *Id.* For example, advisers must indicate if a prime broker has custody of fund assets. Information reported in this section of Schedule D will be publicly available. *Id.* To verify accuracy, investors will be able to compare what is reported on form ADV with offering documents, which discourages advisers from making false representations about service providers. *Id*.

[113] Form ADV, Part 1A, *supra* note 23, at items 5.G., 5.H. (requiring disclosures pertaining to number of clients adviser provided with financial planning services); *see id*. at item 5.I. (asking whether adviser participates in wrap fee program); *id.* at item 5.J. (asking whether the adviser previously indicated it provides investment advice only with respect to limited types of investments).

[114] *Id.* at item 5.E.

[115] *Id.* at item 5.B.(2).

[116] *Id.* at item 5.B.

[117] *Id.* at item 5.B.(6) (specifically excluding investors in private funds adviser advises unless investor also has separate advisory relationship with adviser); *id.* item 5.C.(1) & (2) (asking for number of clients and what percentage of clients are non-US persons).

[118] *See* IAA Release No. 3221, *supra* note 75, at 18 (stating "the amount of assets an adviser has under management will determine whether the adviser must register with the Commission or one or more states.").

[119] *Id.* at 22.

[120] *Id.* at 19 (citing Investment Advisers Act § 203A(a)(2)).

liabilities from the reported AUM. Amended Form ADV also limits investment advisers' discretion in counting or excluding assets from RAUM.[121]

To assess investment advisers' custodial practices, the SEC requires disclosure of clients' assets in custody in Amended Form ADV.[122] To prevent fraud or mistakes, the SEC also requires disclosure of any irregularities.[123] Investment advisers must also indicate the number of persons who are acting as qualified custodians for clients in connection with advisory services.[124] This includes the disclosure of the total U.S. dollar amount held in custody and the total number of clients' cash, bank accounts, or securities subject to adviser or related-person custody.[125]

B. Disclosure

Title IV increases the periodic reporting requirements for registered investment advisers.[126] Form PF (private fund), jointly proposed by the Commodity Futures Trading Commission (CFTC) and the SEC[127] and enacted in October 2011,[128] requires private fund advisers to report RAUM. Form PF was intended to facilitate the FSOC's[129] monitoring of systemic risk in U.S. financial markets[130] and to

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[121] *Id.* at 20-21; Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, § 404, 124 Stat. 1376, 1571–74 (codified as amended at 15 U.S.C. § 80b-4) (giving SEC authority to require reporting and recordkeeping for assets carrying systemic risk); Form ADV, General Instructions, *supra* note 75, instruction 5.b. (precluding advisers from excluding family assets, proprietary assets, assets managed without compensation, and assets of foreign clients when calculating RAUM).

[122] Form ADV, Part 1A, *supra* note 23, at item 9 (stating 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 he provides to clients). *See also* Form ADV, General Instructions, *supra* note 75, Glossary of Terms.

[123] Form ADV, Part 1A, *supra* note 23, item 9.C. (requiring advisers to disclose whether clients with assets under custody receive statements, whether independent public accountant audits client accounts, or whether independent public accountant prepares internal control report with respect to custodial services).

[124] *Id.* at item 9.D. (asking whether adviser or a related person acts as a "qualified custodian" for clients in connection with advisory activities provided to clients, and if so, requiring adviser to identify any related person who acts as a qualified custodian in sec.7.A. of Schedule D, regardless of whether she is operationally independent under Rule 206(4)-2 of the Investment Advisers Act).

[125] *Id.* at item 9.B.

[126] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 § 404(b); 17 C.F.R. § 275.204-2(b)(1) (2013); PF Release, *supra* note 23, at 18.

[127] *See* 17 C.F.R. § 275.204(b)-1 (2013) (requiring private fund advisers to file Form PF with the SEC periodically); *see also* 17 C.F.R. § 4.27 (requiring private fund advisers to file Form PF if they are registered as commodity pool operators or commodity trading advisors); PF Release, *supra* note 23, at 1.

[128] *See* 17 C.F.R. § 275.204-2; PF Release, *supra* note 23, at 192.

[129] *See* PF Release, *supra* note 23, at 4–5, 60 (establishing Financial Stability Oversight Council (FSOC) to monitor and assess risks private funds may pose to US financial system and to promote financial stability); Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 § 112(d)(1) (authorizing FSOC to collect information to support its functions).

[130] PF Release, *supra* note 23, at 9; Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 § 112(a)(1):

> The purposes of the Council are—

improve investigations and examinations by the SEC and the CFTC.[131]

Form PF was implemented in two stages. In stage one, the Form PF requirements became effective on June 15, 2012, for hedge fund, liquidity fund, and private equity fund advisers with $5 billion or more AUM.[132] To determine the AUM, the SEC used the advisers' AUM calculations from the fiscal quarter that ended before June 15, 2012.[133] Hedge fund advisers with over $5 billion AUM in the March 31st fiscal quarter were required to file Form PF by August 29, 2012, because that date is sixty days after their June 30th fiscal quarter.[134] A liquidity fund adviser with over $5 billion AUM in the March 31st fiscal quarter had to file by July 16, 2012, fifteen days after June 30th (actually sixteen days because July 15th was a Sunday).[135] A private equity adviser with over $5 billion AUM in the March 31st fiscal quarter was required to file by October 28, 2012, 120 days after June 30th.[136] In stage two, registered investment advisers with more than $150 million AUM in private funds were required to file Form PF after the end of their first fiscal year or fiscal quarter, as applicable, ending on or after December 15, 2012.[137] Applying Form PF filing criteria meant that hedge fund managers with at least $150 AUM but less than $5 billion AUM were required to file their Form PF filing in 2013.[138]

Investment advisers' RAUM can trigger Form PF filing requirements.

> (A) to identify risks to the financial stability of the United States that could arise from the material financial distress or failure, or ongoing activities, of large, interconnected bank holding companies or nonbank financial companies, or that could arise outside the financial services marketplace;
> (B) to promote market discipline, by eliminating expectations on the part of shareholders, creditors, and counterparties of such companies that the Government will shield them from losses in the event of failure; and
> (C) to respond to emerging threats to the stability of the United States financial system.

Id. Jason Rudderman, *Eliminating Wall Street's Safety Net: How a Systemic Risk Premium Can Solve "Too Big to Fail"*, 11 FLA. ST. U. BUS. R. 39, 46 (2012); Saule T. Omarova, *Bankers, Bureaucrats, and Guardians: Toward Tripartism in Financial Services Regulation*, 37 J. CORP. L. 621, 627 (2012) ("The Dodd-Frank Act seeks to achieve its ambitious goal of containing systematic risk in the financial sector through a wide range of measures."); EDWARD V. MURPHY & MICHAEL B. BERNIER, CONG. RESEARCH SERV., R42083, FINANCIAL STABILITY OVERSIGHT COUNCIL: A FRAMEWORK TO MITIGATE SYSTEMIC RISK (2011) (describing mission, membership, and scope of FSOC, and providing an analysis of several major policy issues related to FSOC that may come before 112th Congress).

[131] *See* Cheryl Nichols, *Addressing Inept SEC Enforcement Efforts: Lessons from Madoff, the Hedge Fund Industry, and Title IV of the Dodd-Frank Act for U.S. and Global Financial Systems*, 31 NW. J. INT'L L. & BUS. 637, 683 (2011) (stating changes to the Dodd-Frank Act that aim to improve SEC investigations); Anita K. Krug, *Institutionalization, Investment Adviser Regulation, and the Hedge Fund Problem*, 63 HASTINGS L.J. 1, 27 (2011) ("The amendments further allow the SEC to mandate periodic reports from private fund advisers for possible use by the Financial Stability Oversight Council in assessing systematic risk.").

[132] PF Release, *supra* note 23, at 117–18.

[133] *See id.* at 117.

[134] *See id.*

[135] *See id.* at 54, 117.

[136] *See id.* at 117–18.

[137] *See id.* at 118; Form PF, *supra* note 23, instruction 9.

[138] *See* PF Release, *supra* note 23, at 118.

Investment advisers, commodity pool operators, and commodity trading advisers (CTAs) registered with the SEC and managing at least $150 million AUM must periodically file Form PF.[139] Private funds with less than $150 million AUM are not required to file Form PF.[140] To reflect the relative risks that each type of adviser poses, the SEC takes a tiered approach to Form PF filing requirements. Hedge fund advisers with less than $1.5 billion RAUM in value attributable to hedge funds are required to complete and file Form PF on an annual basis.[141] Investment advisers with at least $1.5 billion RAUM attributable to hedge funds,[142] i.e., large hedge fund advisers must update Form PF filings on a quarterly basis.[143] Mandatory quarterly reporting for large hedge fund advisers in the United States is intended to provide the FSOC with timely data to identify emerging trends in systemic risk and align with international trends.[144]

Form PF requires investment advisers to provide information about themselves, the funds they manage, and individual investors.[145] Form PF also requires disclosures pertaining to the investment adviser's strategies, performance and changes in performance, the products used by the investment adviser, financing information, risk metrics, credit exposure, and positions held by the investment advisor, among others.[146]

As for the hedge funds that the investment adviser advises, Form PF requires a listing of Net Asset Value (NAV) managed by the adviser by hedge fund strategy[147] and the percentage of the reporting fund's NAV managed using computer-driven trading algorithms.[148] Form PF also requires investment advisers to disclose the reporting fund's greatest net counterparty credit exposure,[149] including the name of creditors and the dollar amount owed to each creditor,[150] information about collateral and credit support,[151] and changes in market factors and their effect on the long and short components of the portfolio as a percentage of NAV.[152]

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[139] *See id.* at 18, 183.

[140] *See id.* at 19, 49.

[141] *See id.* at 50; Form PF, *supra* note 23, at instruction 9 (providing different filing periods for different types of advisers).

[142] *See* 17 C.F.R. § 275.204(b)-1 (2013) (defining term "large hedge fund adviser"); Form PF, *supra* note 23, § 2a, instruction 3 (same).

[143] PF Release, *supra* note 23, at 50; Form PF, *supra* note 23, instruction 9 (stating large hedge fund advisers "must file a *quarterly update* that updates the answers to all Items in this Form PF relating to the *hedge funds* that you advise.") (emphasis in original).

[144] *See* PF Release, *supra* note 23, at 53.

[145] *See* Form PF, *supra* note 23, § 1a; 17 C.F.R. § 279.9 (establishing filing requirements for Form PF).

[146] *See* Form PF, *supra* note 23, at § 1a.

[147] Form PF, *supra* note 23, at § 1a, item B.3., § 1c, item B.20. (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, and (h) Funds and accounts other than private funds).

[148] *See id.* at § 1c, item B.21.

[149] *See id.* at § 1c, items B.22. & 23.

[150] *Id.* at § 2b, item D.47.

[151] *Id.* at § 2b, item B.36.

[152] Form PF, *supra* note 23, at § 2b, item C.42.

Trading and clearing mechanisms constitute another important reporting item in Form PF.[153] Form PF requests information about the investment adviser's exposure of long and short positions[154] and the value of turnover by asset class in the respective reporting month.[155] These requirements are intended to enable the SEC to understand the exposure of the advised hedge funds and their assets. Form PF also requires the investment adviser to disclose the reporting fund's positions and how long it would take to liquidate them.[156] This requirement is meant to help the SEC understand the liquidity of the reporting fund's portfolios. Investment advisers must also report the value of the advised funds' borrowings, the types of creditors,[157] and the aggregate value of all derivative positions for each advised fund.[158] Finally, Form PF requires investment advisers to disclose investors' liquidity, measured by time period and percentage of NAV locked,[159] and the reporting fund's restrictions on investor withdrawals and redemptions.[160]

III. SYSTEMIC RISK AND BANKRUPTCY DISCLOSURE COMMONALITIES

Fulfilling its mandate under Title IV of the Dodd-Frank Act, only seven months after the introduction of Revised Rule 2019, the SEC promulgated systemic risk disclosure requirements for private fund advisers in Form PF.[161] Bankruptcy and systemic risk disclosure obligations for hedge funds have different origins and are intended for different purposes. Bankruptcy disclosures are generally intended to level the playing field in the bankruptcy and restructuring process.[162] Systemic risk

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[153] *Id.* at § 2a, item A.26.

[154] *Id.* at § 1c, items B.22. & 23., § 2b, item B.30. (pertaining to investment advisers that advise more than one hedge fund).

[155] *Id.* at § 2a, item A.27.

[156] *Id.* at § 2b, item B.32.

[157] *Id.* at § 2b, item D.43.

[158] *Id.* at § 2b, item D.45.

[159] *Id.* at § 2b, item E.50.

[160] *Id.* at § 2b, item E.49.

[161] *See* PF Release, *supra* note 23, at 142.

[162] Ilan D. Scharf, *Show and Tell: Ad Hoc Committees' Rule 2019 Disclosures Under Examination*, AM. BANKR. INST. J., Mar. 2009, at 58–59:

> The Bankruptcy Code recognizes the importance of *ad hoc* committees, and Rule 2019 provides a means of mitigating the risks of their participation in the reorganization process. Rule 2019 is derived from Rule 10-211 of chapter X of the old Bankruptcy Act, which was adopted largely as a result of a Securities and Exchange Commission (SEC) report on the "Study and Investigation of the Work. Activities, Personnel and Functions of Protective and Reorganization Committees" (1937), and "is part of the disclosure scheme of the Bankruptcy Code and is designed to foster the goal of reorganization and plans which deal fairly with creditors and which are arrived at openly."

Id. (citations omitted). Manuel D. Leal, *Discovery Under Bankruptcy Procedure: A "Trap Door?"*, 84 N.D. L. REV. 111, 129–30 (2008).

disclosures are meant to help the SEC and FSOC ascertain and prevent systemic implications deriving from hedge funds' investments.[163]

The two disclosure systems evolved differently based on their respective purposes. Before the *Northwest Bankruptcy proceedings*,[164] old Rule 2019 was rarely litigated in chapter 11 cases and it was generally not applied to informal or *ad hoc* committees or groups.[165] This trend was reversed after the *Northwest* case.[166] Disclosures by hedge fund advisers in bankruptcy therefore evolved in the context of the application of old and later Revised Rule 2019. By contrast, Congress enacted PFIARA in Title IV of the Dodd-Frank Act[167] to close regulatory gaps and end the speculative trading practices that contributed to the 2008 financial market crisis.[168] Title IV and SEC implementation rules establish rules and procedures for the registration of private funds and the disclosure of certain proprietary information to the SEC. The Dodd-Frank Act authorizes the SEC to share the collected systemic risk data with the FSOC for ongoing systemic risk analysis of the investment management industry.[169] Title IV is the final chapter in a debate between regulators and the private fund industry over the adequate level of disclosures that spanned more than thirty years.

Despite the different origin and evolution of hedge funds' bankruptcy and systemic risk disclosure obligations, significant commonalities exist between Revised Rule 2019 and Form PF disclosure requirements. Core commonalities between Revised Rule 2019 disclosure of all "disclosable economic interests" and

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> Honesty, candor, and good faith, particularly as to disclosures, are absolutely critical for the intended functioning of bankruptcy law. Without these, the bankruptcy jurisprudential process designed for the honest but unfortunate debtor simply cannot function correctly. Honesty is the foundation for the entire bankruptcy law regardless of whether the discovery rules are implicated . . . . Several sections of the bankruptcy code affecting the rights and duties of debtors reflect the necessity of good faith.

Id. Bo J. Howell, *Hedge Funds: A New Dimension in Chapter 11 Bankruptcy Proceedings*, 7 DEPAUL BUS. & COM. L.J. 35, 49–50 (2008) (stating "some bankruptcy players are likely to be familiar with hedge funds, but the rule [Rule 2019] levels the playing field for all participants. Most hedge funds are relatively new, and their participation in bankruptcy proceedings has been brief.").

[163] PF Release, *supra* note 23, at 4–5, 60 (establishing Financial Stability Oversight Council (FSOC) to monitor and assess risks that private funds may pose to US financial system and to promote financial stability, and explaining Form PF is designed "to collect information to assist FSOC in monitoring and assessing systemic risks that private funds may pose").

[164] *In re* Nw. Airlines Corp., 363 B.R. 701 (Bankr. S.D.N.Y. 2007); *In re* Nw. Airlines Corp., 363 B.R. 704 (Bankr. S.D.N.Y. 2007).

[165] Yeatter, *supra* note 53, at 24 ("Before *Northwest*, Rule 2019 was rarely litigated and generally conceded not to apply to informal or *ad hoc* committees or groups."); Scharf, *supra* note 162, at 59 (stating "adherence to Rule 2019's disclosures by *ad hoc* committees has historically been lax.").

[166] Yeatter, *supra* note 53, at 24.

[167] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, §§ 401–16, 124 Stat. 1376, 1570–80 (codified at 15 U.S.C. §§ 80b-2, 80b-3, 80b-4, 80b-10, 80b-11, 80b-18, 80b-20 (2012)).

[168] *See* Braithwaite, *supra* note 66.

[169] PF Release, *supra* note 23, at 4–5, 60.

Form PF systemic risk disclosures include: disclosure and breakdown of regulatory Assets Under Management (AUM), gross and net asset value, the value of a reporting fund's investments in equity of other private funds, and the aggregate gross asset value of the reporting fund's controlled portfolio companies. Similarly, both Revised Rule 2019 and Form PF require disclosure of derivative positions.

Table 1 illustrates the correlation between systemic risk disclosures in Form PF and required disclosures under Revised Rule 2019. While "disclosable economic interest" in Revised Rule 2019 is a broad and all-encompassing term, many items in Form PF encompass rather similar disclosure items. These items include a breakdown of AUM and net assets,[170] the gross and net asset value of reporting funds,[171] the value of the reporting fund's investments in equity of other private funds,[172] the value of all parallel managed accounts related to the reporting funds,[173] aggregate hedge fund exposures,[174] reporting fund exposures,[175] reporting fund assets,[176] the aggregate gross asset value of the reporting fund's controlled portfolio companies,[177] the aggregate principal amount of borrowings categorized as current liabilities on the most recent balance sheets of the reporting fund's controlled portfolio companies,[178] and the aggregate principal amount of borrowings categorized as long-term liabilities on the most recent balance sheets of the reporting fund's controlled portfolio companies.[179] While disclosures under Revised Rule 2019 are directly tailored to hedge funds' respective investments pertaining to a bankruptcy proceeding, disclosures under Form PF are more generic and not tailored to any specific investment.

Table 1 also underscores commonalities in terms of timing of disclosures and the date of acquisition of the disclosable economic interest. Revised Rule 2019 requires disclosures as of the date the entity was employed or the group or committee was formed.[180] Moreover, other means of discovery of disclosable

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[170] Form PF, *supra* note 23, at § 1a, item B.3.
[171] *Id.* at § 1b, items B.8.–9.
[172] *Id.* at § 1b, item B.10.
[173] *Id.* at § 1b, item B.11.
[174] *Id.* at § 2a, item A.26.
[175] *Id.* at § 2b, item B.30.
[176] *Id.* at § 3, item B.55.
[177] *Id.* at § 4, item B.70.
[178] *Id.* at § 4, item B.71.
[179] *Id.* at § 4, item B.72.
[180] FED. R. BANKR. P. 2019(c)(2)(B) & (C). Under certain circumstances, the verified statement shall include:

> [T]he nature and amount of each disclosable economic interest held in relation to the debtor as of the date the entity was employed or the group or committee was formed; and . . . with respect to each member of a group or committee that claims to represent any entity in addition to the members of the group or committee, other than a committee appointed under § 1102 or § 1114 of the Code, the date of acquisition by quarter and year of each disclosable economic interest, unless acquired more than one year before the petition was filed[.]

economic interests are available under Revised Rule 2019 and the court can order the disclosure of relevant information pursuant to authority outside of Revised Rule 2019.[181] As previously noted, Form PF, on the other hand, is filed depending on the size of the investment adviser, with some advisers required to file quarterly and some annually.[182] It is important to note that for purposes of any analysis of filed data under either disclosure system, there is a serious risk that data may be out of date and less accurate when analysed than at the time when it was disclosed. This is partially due to the time needed for data collection before eventual filing. Many disclosed positions and/or disclosable economic interests may already be out of date by the time they are filed and submitted. This lack of accuracy can affect systemic risk evaluation more than an evaluation of disclosures in the bankruptcy context because many distressed investment strategies depend on the outcome of the restructuring process and creditors may be incentivized to maintain their respective positions until the completion of the restructuring process.

Commonalities also exist in terms of required disclosures of derivative positions. Under Revised Rule 2019, a disclosable economic interest includes derivative positions such as short positions, credit default swaps, and total return swaps, among other types of holdings.[183] Similarly, Form PF requires disclosures pertaining to the aggregate value of all derivative positions,[184] including reporting funds' strategies as percentage of NAV.[185] Importantly, Form PF's required disclosure of reporting funds' strategies includes a separate subcategory for "Event Driven, Distressed/Restructuring".[186] Form PF also requires the disclosure of a detailed listing of dollar value exposure by asset class, including asset backed securities and structured products, credit derivatives, foreign exchange derivatives, interest rate derivatives, and commodities (physical/derivatives).[187]

The enforceability of disclosable information is nominally the same for both disclosure regimes. Rule 2019 provides rather broad enforcement mechanisms,

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Id.

[181] FED. R. BANKR. P. 2019 advisory committee's note ("Although the rule no longer requires the disclosure of the precise date of acquisition or the amount paid for disclosable economic interests, nothing in this rule precludes either the discovery of that information or its disclosure when ordered by the court pursuant to authority outside this rule.").

[182] PF Release, *supra* note 23, at 50; Form PF, *supra* note 23, instruction 9 (providing different filing periods for different types of advisers).

[183] FED. R. BANKR. P. 2019 advisory committee's note.

> The definition of the term is intended to be sufficiently broad to cover any economic interest that could affect the legal and strategic positions a stakeholder takes in a chapter 9 or chapter 11 case. A disclosable economic interest extends beyond claims and interests owned by a stakeholder and includes, among other types of holdings, short positions, credit default swaps, and total return swaps.

Id.

[184] Form PF, *supra* note 23, § 1b, item B.13.

[185] *Id.* at § 1c, item B.20.

[186] *Id.*

[187] *Id.* § 2a, item A.26.; *id.* § 2b, item B.30.

including a provision that allows the court to "grant other appropriate relief."[188] By contrast, SEC enforcement actions in the context of Form PF filings are rather limited. Form PF disclosures have not yet been standardized, and anecdotal evidence suggests that the SEC and the FSOC could be working with contradictory, misleading, inaccurate, and incomplete systemic risk data in Form PF.[189] While the SEC is still ascertaining the appropriate use of Form PF and improving Form PF and the instructions to it, it is unlikely that the SEC's enforcement division will start investigations into alleged misreporting or failures to report.

Category	**Rule 2019 (as amended Dec. 2011)**	**Form PF**
Description:	Disclosure Regarding Creditors and Equity Security Holders in Chapter 9 & Chapter 11 Cases	Investment advisers registered or required to register under section 203 of the IAA (15 U.S.C. 80b–3) as an investment adviser to one or more private funds.
Effective Date:	December 1, 2011	Stage 1: June 15, 2012 - large hedge fund and liquidity fund advisers Stage 2: December 15, 2012, all other filers
Application:	"Each member of a group or committee" creditors or equity holders that are "acting in concert," and "entities" that represent them	Investment advisers registered or required to register: Reporting Fund Liquidity Funds Private Equity Fund

[188] FED. R. BANKR. P. 2019(e)(2).

> If the court finds such a failure to comply it may:
> (A) refuse to permit the entity, group or committee to be heard or to intervene in the case;
> (B) hold invalid any authority, acceptance, rejection, or objection given, procured, or received by the entity, group, or committee; or
> (C) grant other appropriate relief.

Id.

[189] *See* Kaal, *FSOC Systemic Risk*, *supra* note 28.

Timing:	As of the date the entity was employed or the group or committee was formed	> 1.5 bil. AUM – Quarterly < 1.5 bil. AUM – Annually
Required Disclosure:	Verified statement including: (c) (2) (B) the nature and amount of each disclosable economic interest held in relation to the debtor as of the date the entity was employed or the group or committee was formed. (a) (1) "Disclosable economic interest" means any claim interest, pledge, lien, option, participation, derivative instrument, or any other right or derivative right granting the holder an economic interest that is affected by the value, acquisition, or disposition of a claim of interest."	• Item 3: Breakdown of AUM and net assets • Items 8 & 9: Gross and net asset value of reporting fund • Item 10: Value of reporting fund's investments in equity of other private funds • Item 11:Value of all parallel managed accounts related to the reporting fund • Item 26: Aggregate hedge fund exposures • Item 30: Reporting fund exposures • Item 55: Reporting fund assets • Item 70: Aggregate gross asset value of the reporting fund's controlled portfolio companies • Item 71: Aggregate principal amount of borrowings categorized as current liabilities on the most recent balance sheets of the reporting fund's controlled portfolio companies • Item 72: Aggregate principal amount of borrowings categorized as long-term liabilities on the most recent balance sheets of the reporting fund's controlled portfolio companies

Disclosure of Derivative Positions:	FED. R. BANKR. P. 2019 advisory committee's note: "The definition of the term is intended to be sufficiently broad to cover any economic interest that could affect the legal and strategic positions a stakeholder takes in a chapter 9 or chapter 11 case. A disclosable economic interest extends beyond claims and interests owned by a stakeholder and includes, among other types of holdings, short positions, credit default swaps, and total return swaps."	• Item 13: Aggregate value of all derivative positions • Item 20: Reporting fund's strategies as % of NAV – Including category "Event Driven, Distressed/Restructuring" • Items 26 & 30: Detailed listing of dollar value exposure by asset class including: o ABS/structured products o Credit derivatives o Foreign exchange derivatives o Interest rate derivatives o Commodities (physical/derivatives)
Date of Acquisition:	(c)(2)(B): "the nature and amount of each disclosable economic interest held in relation to the debtor as of the date the entity was employed or the group or committee was formed; and (C) with respect to each member of a group or committee that claims to represent any entity in addition to the members of the group or committee, other than a committee appointed under § 1102 or § 1114 of the Code, the date of acquisition by quarter and year of each disclosable economic interest, unless acquired more than one year before the petition was filed; FED. R. BANKR. P. 2019	> 1.5 bil. AUM – Quarterly < 1.5 bil. AUM – Annually

	advisory committee's note: "Although the rule no longer requires the disclosure of the precise date of acquisition or the amount paid for disclosable economic interests, nothing in this rule precludes either the discovery of that information or its disclosure when ordered by the court pursuant to authority outside this rule."	
Failure to Comply:	(e) (1) Court determines failure to comply. (e)(2) If the court finds such a failure to comply it may: (A) refuse to permit the entity, group or committee to be heard or to intervene in the case; (B) hold invalid any authority, acceptance, rejection, or objection given, procured, or received by the entity, group, or committee; or (C) grant other appropriate relief.	SEC Enforcement Division

Table 1. Disclosure Commonalities Between Dodd-Frank Systemic Risk Disclosures Under the Dodd-Frank Act and SEC Implementation Rules and Bankruptcy Disclosures for Hedge Funds Investing in Distressed Assets.

In addition to the commonalities described in Table 1 and analyzed above, the bankruptcy process could benefit from certain other generic yet possibly relevant disclosures found in Form PF. These disclosure items include reporting fund performance in percent monthly,[190] reporting fund strategy in percent of net asset value,[191] the percentage of high frequency trading strategies,[192] counterparty credit exposure as a percent of net asset value,[193] the percentage of securities traded on an exchange versus OTC and bilateral transactions,[194] and the name of each creditor holding an interest of more than five percent of the reporting fund's net asset value as of the data reporting date.[195] The author recognizes that the additional disclosure items in Form PF are generally too generic for the bankruptcy process. However, given the hedge fund industry's continuous, expanding, and increasingly assertive presence in distressed securities investments and possible future changes in the distressed securities market, some of these systemic risk disclosures could become more relevant for the bankruptcy process.

IV. SYSTEMIC RISK DISCLOSURES IN BANKRUPTCY

Systemic risk disclosure obligations in Form PF were created, albeit in a different context than bankruptcy, to circumvent the very shadow activities that appear to be resurfacing in the bankruptcy context under Revised Rule 2019. Revised Rule 2019 may in effect result in less overall disclosure of creditor activities in the bankruptcy process and may push bankruptcy creditors into the shadows[196] By contrast, hedge fund adviser registration and disclosure requirements under Title IV and SEC implementation rules were instituted to avoid hedge funds operating in the shadows of financial markets.[197] The author does not claim that the origin of Form PF disclosures suggests the application of these disclosure requirements in the bankruptcy context. It is noteworthy, however, that Form PF was created in a systemic context to avoid hedge funds' shadow operations, which Revised Rule 2019 appears to have partially facilitated in the bankruptcy context.

The commonalities of hedge fund adviser disclosures under Revised Rule 2019 and systemic risk disclosures under Form PF [198] in combination with the uncertainties created by Revised Rule 2019[199] suggest that there could be a possible future role for systemic risk disclosures in bankruptcy. Should revised Rule 2019 result in less overall disclosure by distressed hedge fund investors in the bankruptcy

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[190] Form PF, *supra* note 23, § 1b, item C.17.
[191] *Id.* at § 1c, item B.20.
[192] *Id.* at § 1c, item B.21.
[193] *Id.* at § 1c, item B.22.; *id.* § 2b, items B.36., 38.
[194] *Id.* at § 1c, item B.24.
[195] *Id.* at § 2b, item D.47.
[196] *See supra* notes 21, 64 and accompanying text (effects of Revised Rule 2019).
[197] *See* FINANCIAL REGULATORY REFORM, *supra* note 69, at 37; Kanjorski Statement, *supra* note 84, at H14419–20; Goldfarb & Cho, *supra* note 71; Braithwaite, *supra* note 66.
[198] *See supra* Part III.
[199] *See supra* Part II.

process,[200] systemic risk disclosures could at least partially fill this void with already existing disclosures in Form PF. While Form PF disclosures in their existing format are too generic for appropriate application in the bankruptcy context, experience with and standardization of Form PF disclosures could result in less generic disclosures that could, over time, be increasingly relevant in the bankruptcy context.

The threat of disclosure of systemic risk filings in combination with increasing competition in the distressed-debt market could impact hedge fund investors' incentives cooperation and disclosure in the bankruptcy process. If systemic risk data in Form PF becomes publicly available or even only available to the respective bankruptcy judge in a chapter 9 or chapter 11 case, the hedge fund industry's penchant for secrecy could perhaps precipitate a change in hedge funds' distressed investment practices. The threat of public disclosure of hedge funds managers' systemic risk filing could help incentivize hedge fund investors to abstain from trading while on a committee. Similarly, hedge funds could be incentivized to avoid holding multiple and offsetting positions in distressed entities to facilitate their hidden agendas.

Exclusive disclosure of otherwise private and proprietary systemic risk data in Form PF to bankruptcy judges could potentially alleviate the hedge fund industry's concerns over privacy and reverse engineering of strategies and positions. Allowing only the judge to access creditors' systemic risk filings would provide no additional information for debtors and par creditors who paid face value. However, making creditors' Form PF data available for the eyes of the judge only could raise issues in the litigation process because parties may demand access to the same information. On the other hand, Section 107 of the Bankruptcy Code requires the bankruptcy court to protect proprietary information.[201]

Systemic risk disclosures in bankruptcy would increase the overall level of hedge funds' disclosures in the bankruptcy context. A long debate over hedge funds' disclosure obligations in the bankruptcy context has resulted in two camps—one favoring hedge funds' disclosures and one disfavoring them.[202]

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[200] *See* Lipson, *supra* note 12, at 1637, 1639, 1641.

[201] *See* 11 U.S.C. § 107 (2012) (providing on request of a party in interest, bankruptcy court must protect trade secret, confidential research, development, or commercial information).

[202] Given the similar scope and overall commonalities in required disclosures under Form PF and Revised Rule 2019, the arguments for and against systemic risk disclosures in bankruptcy may largely follow the arguments over disclosure requirements under old Rule 2019. Old Rule 2019 required any entity or unofficial committee representing more than one creditor or equity security holder in a bankruptcy proceeding to disclose the name and address of the creditor as well as the nature and amount of the claim and the time of acquisition. FED. R. BANKR. P. 2019(a) (2010) (amended 2011). The Rule requires the disclosure of:

> (1) the name and address of the creditor or equity security holder; (2) the nature and amount of the claim or interest and the time of acquisition thereof unless it is alleged to have been acquired more than one year prior to the filing of the petition; (3) a recital of the pertinent facts and circumstances in connection with the employment of the entity . . . ; and (4) . . . the amounts of claims or interests owned by the entity, the members of

Commentators who favor hedge fund disclosures use the necessity of understanding hedge funds' motivations as a core argument for increased disclosure obligations.[203] Without such disclosure, arguably hedge fund investors in distressed securities can abuse the bankruptcy process for their own and exclusive financial gain.[204] Understanding the motives of distressed investors may be necessary to ensure a level playing field in the bankruptcy process.[205] Opponents of disclosures point out that there are generally no fiduciary duties between investors.[206] Investors' voting of bankruptcy claims in their own economic interest is not unethical or illegal.[207]

> the committee or the indenture trustee, the times when acquired, the amounts paid therefor, and any sales or other disposition thereof.

Id.

[203] Levitin, *supra* note 7, at 67.

> This Article argues that a more productive approach to claims trading must begin with a better understanding of its nuances. It shows that claims trading is a complex, multi-dimensional, and dynamic market with tremendous variation by timing, asset class, and trading motivation, and with different impacts on the bankruptcy reorganization process.

Id. Flaschen & Mayr, *supra* note 53, at 997.

> *Reason # 4: Disclosure is necessary to understand hedge fund motivations*
> Hedge funds, like all other investors, desire to maximize the return on their investment. . . . For some, this return focuses purely on the maximum current economic recovery. For others, this return focuses on the maximum long-term economic recovery. For others still, the focus is on a combination of value and liquidity. And the foregoing do not include the other nonmonetary return considerations relevant to many trade creditors, landlords, employees, etc.
> In sum, hedge funds are just like other participants in the process. They are individual stakeholders who have individual needs and individual motivations based on a great variety of factors that may or may not coincide with the needs and motivations of any other [stakeholder.]

Id.

[204] *See* Flaschen & Mayr, *supra* note 53 at 997–98.

[205] *See supra* note 162 and accompanying text.

[206] Jay M. Goffman, Mark A. McDermott & Andrew M. Thau, *Distressed Investing: Selected Topics***,** AM. BANK. INST. J., Oct. 5, 2007, at 5.

> The increase in distressed investing, particularly by hedge funds, has resulted in the proliferation of ad hoc committees. Indeed, distressed investors have increasingly turned to ad hoc committees to take advantage of their many benefits. First, recent ad hoc committees have operated under the presumption that they do not have fiduciary duties to other stakeholders, including to the class by which they identify themselves, leaving them free to pursue their own agendas.

Id. Flaschen & Mayr, *supra* note 53, at 987 ("Further, despite the fact that these groups are often referred to as ad hoc 'committees,' many practitioners have always believed that Rule 2019 was not intended to apply to these informal groups because they do not act in a representative/fiduciary capacity.").

[207] *See* John Hancock Mut. Life Ins. Co. v. Route 37 Bus. Park Assoc.'s, 987 F.2d 154, 161 (3d Cir. 1993) ("Absent bad faith or illegality (*see* 11 U.S.C. § 1126(e) (1988)), the Code is not concerned with a claim holder's reason for voting one way or the other, and undoubtedly most claim holders vote in accordance with

Another core argument in favor of disclosure pertains to the need to limit the influence of hedge funds in the bankruptcy process.[208] One-sided bargaining strength in the reorganization process can result from the lack of creditor disclosures in the bankruptcy process.[209] On the other hand, hedge fund investments

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their overall economic interests as they see them."); Flaschen & Mayr, *supra* note 53, at 998 ("There is nothing illegal or unethical about having a diverse investment portfolio. And there is nothing illegal or unethical in voting one's bankruptcy claims in furtherance of one's own economic interest.").

[208] *See, e.g.*, Michelle Harner, *Trends in Distressed Debt Investing: An Empirical Study of Investors' Objectives*, 16 AM. BANKR. INST. L. REV. 69, 72 (2008).

> I base this article on an empirical study of 364 institutional investors . . . . The data confirm several of the common perceptions of distressed debt investors. For example, 65.5% of the distressed debt respondents responding to the applicable question stated that they use their distressed debt investments to try to influence board or management decisions . . . . These investors are willing to use their debt holdings to try to influence financial and operational decisions, presumably to increase the return on their investments.

Id. Hotchkiss & Mooradian, *supra* note 6, at 402 ("This market has increased the potential for external agents known as 'vulture' investors to influence restructurings and discipline managers of distressed firms."); Robert J. Rosenberg & Michael J. Riela, *Hedge Funds: The New Master of the Bankruptcy Universe*, 17 NORTON J. BANKR. L. & PRAC. 701 (2008); DeMarino, *supra* note 48, at 182 ("Proponents of Rule 2019's applicability to hedge funds argue that hedge funds are a disruptive force in bankruptcy cases, in particular Chapter 11 reorganizations."); Kidder, *supra* note 60, at 841.

> Hedge funds in and of themselves are not a hazard to the bankruptcy system; in fact, they arguably add value to the process. However, when hedge funds and other sophisticated creditors engage in trading strategies that render their economic risk disproportionately small in relation to their contractual rights, they pose a threat to the stability of the corporate reorganization process. To address this threat, Rule 2019 must be amended to ensure that all parties involved in a bankruptcy case are aware of creditors' true economic incentives.

Id. Howell, *supra* note 162, at 50 ("[S]ome bankruptcy players are likely to be familiar with hedge funds, but the rule levels the playing field for all participants.").

[209] *See* Scharf, *supra* note 162, at 58.

> Entities that buy and trade securities—especially when purchased at a discount—are generally reluctant to share with the public the information required by Rule 2019 because, among other things, (1) they may be actively trading in the market, (2) disclosure may weaken their bargaining power and (3) disclosure may illuminate actual or perceived conflicts where members hold different types of claims against or interests in a debtor.

Id. Lipson, *supra* note 12, at 1652 ("According to Judge Gerber, 'failures to provide the information actually required by Rule 2019 . . . are widespread, and failures to make all of the required disclosures are the rule, not the exception.'"); Alexander, *supra* note 27, at 1438.

> Hedge funds are specifically formed in such a way as to avoid regulations that require them to disclose how they conduct their business. More than anything, they seek to keep their trading information private. If forced to disclose this information, including the price and date that they acquired their claims, it is highly possible that hedge funds will no longer invest in distressed claims and securities. This decrease in the trading

in distressed securities provide much needed liquidity for investors seeking exit[210] and it is not the creditor but rather the debtor who in most cases opposes secondary market participants in the reorganization process.[211]

> markets will in turn prevent holders of distressed claims from liquidating their claims prior to the conclusion of the bankruptcy case.

Id.

[210] Howell, *supra* note 162, at 35.

> The growing financial pressure on hedge funds is increasingly driving them into the bankruptcy realm. Hedge fund involvement in bankruptcy is relatively new, but their presence brings a great deal of liquidity and sophistication to bankruptcy cases. As active debt and equity traders, hedge funds are increasingly turning to distressed investment, which brings them into direct contact with the bankruptcy system.

Id. Thomas C. Pearson & Julia Lin Pearson, *Protecting Global Financial Market Stability and Integrity: Strengthening SEC Regulation of Hedge Funds*, 33 N.C. J. INT'L L. & COM. REG. 1, 5–6 (2007).

> By actively participating in secondary markets and the market for derivatives, hedge funds bring market liquidity to the capital markets. They also play an important role in financial innovation and the reallocation of financial risk. Because of the benefits provided by hedge funds, any regulations should not eliminate their ability to positively impact the financial markets.

Id. Alexander, *supra* note 27, at 1437 ("Despite the discounted prices at which they acquire distressed claims, investors like hedge funds can offer sellers much needed liquidity."); Eisenberg, *supra* note 4.

> Increasingly tighter credit markets will create further opportunities for hedge funds to supply cash for debtor-in-possession and exit financing, and relieve traditional institutional lenders of the burdens associated with holding defaulted credits. Trade creditors experiencing liquidity issues may choose to relieve this pressure by selling their unsecured claims to hedge funds.
>
> By acquiring these positions, hedge funds will then be positioned to contribute financial and operational know-how to the debtor's efforts and facilitate an effective and timely reorganization.

Id. DeMarino, *supra* note 48, at 183.

> The secondary debt market is valuable in Chapter 11 proceedings because it promotes reorganization and workout agreements by providing an essential source of liquidity to investors that buy and sell secondary debt. This in turn increases the efficiency of the secondary debt market. Hedge funds are major participants within this market, and they, like any other investor in a market, look to maximize their investment. As a result, hedge funds increase secondary debt liquidity by offering complex and sophisticated solutions to the workout and reorganization process, and therefore, facilitate the goal of collective reorganization. Consequently, if Rule 2019 discourages hedge fund involvement in bankruptcy, liquidity and efficiency in the secondary debt market will diminish, hampering the overall reorganization process.

Id. Menachem O. Zelmanovitz & Matthew W. Olsen, *Rule 2019: A Long Neglected Rule of Disclosure Gains Increasing Prominence in Bankruptcy*, 3 PRATT'S J. BANKR. L. 166, 167 (2007) ("Such private-interest groups contend that requiring such disclosure will create a significant obstacle to the participation of investors who make valuable contributions and bring liquidity to the Chapter 11 process."); Flaschen & Mayr, *supra* note 53. The secondary market:

Disclosure arguably protects against misuse of confidential information in the bankruptcy process and ensures that all investors enjoy the same rights in the same investment.[212] Moreover, they argue that members of ad-hoc groups are not necessarily all likely to misuse confidential information and should, therefore, not be treated the same but rather on a case-by-case basis.[213] Opponents of disclosure obligations also point out that under securities and bankruptcy laws it is the debtor

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> [P]rovides an essential source of liquidity for investors seeking to exit investments in financially distressed companies. The secondary market also ensures that participants in the chapter 11 process consist of those persons who desire to participate, rather than legacy creditors who often want to exit as quickly as possible and will remain silent in the meantime.

Id. Howell, *supra* note 162, at 35 ("Hedge fund involvement in bankruptcy is relatively new, but their presence brings a great deal of liquidity and sophistication to bankruptcy cases. As active debt and equity traders, hedge funds are increasingly turning to distressed investment, which brings them into direct contact with the bankruptcy system.").

[211] Flaschen & Mayr, *supra* note 53, at 993, 995.

> From the debtor's perspective, this is a way to muffle the voice of one of their largest creditor constituencies because the debtor does not agree with the typically more aggressive perspective of secondary market investors and knows that compelled disclosure of trading histories will cause many investors to shy away from group participation. From the investors' perspective, this is a crucial issue relating to their ability to protect their interests on a coordinated and cost-effective basis while maintaining the confidentiality of their sensitive and proprietary business information and strategy. . . .
>
> Thus, in reality, there is plenty of room at the table for institutional investor, commercial lender, trade creditor, and hedge fund alike, and it is really the debtor that primarily opposes the participation of secondary market investors in the reorganization process.

Id.

[212] Alexander, *supra* note 27, at 1420 ("[It] is clear that . . . [Rule 2019] was enacted to specifically address abuses by protective committees in the 1930s that solicited deposit agreements from investors."); Flaschen & Mayr, *supra* note 53, at 998–99.

> *Reason # 5: Rule 2019 protects against misuse of confidential information*
> Rule 2019, a mere procedural rule, has nothing to do with the use of confidential information. Contract law, common law fraud, and, where applicable, the state and federal securities laws regulate the misuse of material, nonpublic information by investors. In bankruptcy, improper use of confidential information may also raise vote designation and/or equitable subordination issues, but the right to compel disclosure of the investor's information in that context flows from normal discovery rules applicable to contested matters where there is a non-frivolous basis to believe that an investor has actually done something wrong. Rule 2019 cannot be used as a preemptive discovery device based upon the presumption that all ad hoc group members are likely to misuse confidential information. This rationale again diverts attention from the real disclosure issue: it is the debtor (not the investors from whom the debtor has raised funds) that has the primary disclosure duties under the applicable bankruptcy and securities laws.

Id.

[213] *See* Alexander, *supra* note 27, at 1447.

who has primary disclosure obligations.[214] Given this emphasis in the law, the expansion of disclosure obligations for creditors may be misplaced.

Unlike hedge funds' bankruptcy disclosures, systemic risk disclosures are generally much more generic and not tailored to the respective distressed investment. Hence, with regard to disclosure of possible motives of hedge fund investors in bankruptcy, systemic risk disclosures in the bankruptcy context would only marginally improve the availability of relevant information pertaining to possible motives of distressed securities investors. Systemic risk disclosures in the bankruptcy process also may not significantly change or limit the influence of hedge funds in the bankruptcy process or protect against misuse of confidential information.

The hedge fund industry opposes the use of systemic risk data in the bankruptcy context. From the perspective of the hedge fund industry, any incremental increase in disclosure obligations affects the industry's profitability.[215] With increased

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[214] Harner, supra note 4, at 201.

> A debtor in bankruptcy has extensive disclosure obligations. Those obligations generally do not apply, however, to creditors, shareholders, or other parties in interest. Rather, these parties typically are not required to make any disclosures until they file a proof of claim or interest, if required, or otherwise seek to be heard in the bankruptcy case.

Id. Craig A. Roeb, *Disclose or Dismiss Part of Any Litigator's Due Diligence Should Be to Determine If the Plaintiff Has A Pending Bankruptcy Action*, L.A. LAW., Nov. 2008, at 25, 26 ("The disclosure obligations of debtors are at the very core of the bankruptcy process. In fact, courts have said that meeting these obligations is part of the price that debtors must pay for receiving a bankruptcy discharge."); Eric Hilmo, *Bankrupt Estoppel: The Case for A Uniform Doctrine of Judicial Estoppel As Applied Against Former Bankruptcy Debtors*, 81 FORDHAM L. REV. 1353, 1368 (2012) ("The duty to disclose does not end at the moment of filing, however, and a debtor seeking bankruptcy protection is said to face substantial and ongoing asset disclosure obligations."); Michael D. Sousa, *A Delicate Balancing Act: Satisfying the Fourth Amendment While Protecting the Bankruptcy System from Debtor Fraud*, 28 YALE J. REG. 367, 414–15 (2011).

> As one commentator has noted, when a debtor fails to live up to the affirmative obligations of disclosure and candor, the debtor undermines the implicit compromise that he strikes with creditors through the bankruptcy process: fair and efficient distribution of all assets in return for a discharge of his debts.

Id. (citation and quotations omitted); Berman & Brighton, *supra* note 32, at 64.

> The benefit/burden concept is nothing new to those players that have been actively participating in the bankruptcy process for a long time: For debtors, if they want the benefit of the automatic stay and the ability to discharge debts, all information is to be made public and management is subject to scrutiny, for secured lenders, if they want the benefits and pricing associated with DIP lending or exit financing, court approval after notice and an opportunity to object is required; and for creditors' committees, if committee members want the benefit of collective participation, they must accept a fiduciary obligation to the class and disclosure rules must be complied with.

Id.

[215] *See* Wulf A. Kaal, *Hedge Fund Regulation via Basel III*, 44 VAND. J. TRANSNAT'L L. 389, 449 (2011).

disclosure obligations, "pilot fish" can increasingly emulate investment strategies and positions. As a result, investment positions can become more expensive and systematic bargaining strength is removed from the negotiation process. Additional regulation changes the working levers of bankruptcy process. Form PF disclosures in the bankruptcy process would change hedge funds' management of timing of disclosures and hedge funds' resulting bargaining strength. Hedge fund representatives are also concerned that disclosure of systemic risk filings could affect judges' perspectives on the claims if judges realize the profitability of hedge funds' investments in the bankruptcy process. Additional disclosures could also unveil hedge funds' relationships in the illiquid market for distressed debt/securities. In summary, there is a real risk that increased disclosures via Form PF would destroy the balance of power in the restructuring process.

Several additional considerations may impact the use of systemic risk data in the bankruptcy process. It is still largely unclear if and how the SEC and the FSOC will be able to evaluate existing Form PF data.[216] Bankruptcy judges and/or the respective parties in a bankruptcy case may be unable to adequately evaluate Form PF data pertaining to a creditor in a bankruptcy case. Moreover, parties run the risk that any Form PF information could be out of date immediately following the filing. The use of generic and possibly outdated systemic risk data in the bankruptcy process would therefore not improve hedge funds' practices in bankruptcy in the near term. The SEC has not yet standardized the required disclosures in Form PF and there is some evidence that the disclosure requirements in Form PF are based on an inconsistent use of industry terms, which may result in inconsistent and perhaps contradictory data reporting.[217] There are also no indications that the SEC will further increase the systemic risk disclosure obligations for hedge funds investing in distressed securities. Based on these observations, the threat of public disclosure of systemic risk filings by hedge funds via the bankruptcy process may only marginally affect hedge funds' tactics and their role in distressed investing. Systemic risk disclosures in the bankruptcy context could be premature, at least in the short term.

CONCLUSION

Public access to systemic risk disclosures by hedge fund managers under the Dodd-Frank Act and SEC implementation rules could improve hedge funds' distressed investments and their bankruptcy practices. Systemic risk disclosures could play a possible role in bankruptcy especially if more evidence emerges suggesting that Revised Rule 2019 could result in less overall disclosure by distressed debt investors. The mere threat of public access or sharing of hedge funds' systemic risk data filings in Form PF filings between the SEC and the federal bankruptcy bench could help facilitate some level of discipline for distressed debt

[216] Kaal, *supra* note 28.
[217] *See id.*

investors' engagements in the bankruptcy process. The commonalities between disclosure requirements under the Dodd-Frank Act and Revised Rule 2019 suggest a possible role for systemic risk disclosures in the bankruptcy process.

Despite these commonalities, however, the existing regulatory framework for systemic risk disclosures is unlikely to change hedge funds' bankruptcy practices in the short term. The disclosure obligations under Form PF are still too generic for appropriate use and application in the bankruptcy process. The SEC has not yet standardized the required disclosures and it is unlikely to enforce Form PF disclosure requirements in the foreseeable future. Furthermore, given the many existing issues with Form PF disclosure obligations, it is unlikely that the SEC will increase the systemic risk disclosure obligations for hedge funds' investments in distressed securities. In the current regulatory environment, the threat of public disclosure of systemic risk filings by hedge funds via the bankruptcy process may only marginally affect hedge funds' tactics and their role in distressed investing.