

---

# TACKLING COMPLIANCE IN THE ALTERNATIVE INVESTMENTS INDUSTRY



**“Compliance is a way of life for fund managers and investment firms, who must deal with regulatory scrutiny and audits on a regular basis.”**

Global alternative assets under management (AUM) are setting new records, [soaring](#) to \$10.3 trillion. Performance was driven in part by large capital flows from investors.

However, to continue to deliver returns for investors, the alternative assets industry must adapt and evolve to address market opportunities and challenges. One way to accomplish this is to develop better strategies for handling compliance.

## THE IMPORTANCE OF COMPLIANCE WITH GLOBAL ALTERNATIVES

Compliance is a way of life for fund managers and investment firms, who must deal with regulatory scrutiny and audits on a regular basis.

Indeed, it is through effective corporate governance that the interests of all stakeholders and the fund’s perception in the financial community can be managed. Governance also provides the structure for accomplishing the fund’s objectives.

---

**CT Tip:** *With the task of compliance audits, it’s best to use [entity management software](#) that streamlines access to compliance data. For example, a robust entity management solution can provide auditors with secure and customized access to entity information, including documents, corporate summary reports, and other comprehensive reports.*

## COMPLIANCE COMPLEXITY – DOMESTIC AND ABROAD

Compliance and reporting present investment fund managers with an abundance of challenges.

Funds are established as business entities — limited liability corporations (LLCs), limited partnerships, corporations, or statutory trusts — and must comply with the business entity statute under which they are formed. In the U.S., there are federal filings. Plus, all states require some form of information reporting (commonly known as annual reports) and keeping up with other entity requirements. Public companies must also monitor officer and director trading activity and SEC compliance rules.

As investment management firms expand globally, they face complex, rapidly evolving, and even conflicting regulatory requirements. Laws and rules can vary by region within a single jurisdiction, and they can change quickly as new laws are passed, expanded, repealed, or amended.

*[continued on page 2](#)*

This information is not intended to provide legal advice or serve as a substitute for legal research to address specific situations.

One such area is [know your client \(KYC\) standards](#). Designed to prevent money laundering, bribery, and other financial crimes, these regulations change frequently as data protection laws evolve worldwide. It is imperative for companies to understand the requirements in each jurisdiction in which they do business (domestic and international) and conduct the necessary due diligence to protect their business against unforeseen reputational damages

### ENTITY COMPLIANCE BY FUND BUSINESS STAGE

Private equity funds have a limited life cycle, typically seven to fifteen years. During this time, fund managers navigate through various stages, including due diligence, marketing, the commitment or investment period, and the post-commitment or divestment period.

If you're a fund manager, here are some of the activities you must consider:

#### Due diligence

Due diligence is significant when performing Uniform Commercial Code (UCC) searches. Even the simplest UCC searches and filings require strong attention to detail. Whether you're conducting a single search or a more complex due diligence strategy, it's crucial the search and filing results are clear, comprehensive, and accurate.

#### Commitment

This process starts with the formation of the fund.

---

**CT Tip:** *At this point, you will need to decide the entity type for the fund (limited partnership, LLC, corporation or trust) and the state of formation. You must also choose and reserve the entity's name, select a Registered Agent and office, file the formation document, and apply for an EIN.*

Each state has different time frames or turnaround times when it comes to filing documents. Some states offer expedited service, while others do not and may take weeks. Some states give you the date of submission as the file date, while others do not.

It's important to know the state requirements and be prepared. You may need something done tomorrow but discover that the state has a turnaround time of a week. This could impact the deal significantly.

Another step is the formation of the entity that will act as the fund manager. Similar steps are involved as in the formation of the entity that will own and operate the fund. You will then determine the terms of the fund and have legal counsel draft the offering documents, which include the limited partnership agreement or limited liability company agreement, the private placement memorandum, and the subscription agreements.

In addition, there are business license requirements that will need to be met at the start of and during the entity's lifecycle.

#### Investment

This is when you'll start deploying the fund's capital into investments.



**“There are many pitfalls to navigate, and compliance missteps can result in fines, damaged reputation, and an inability to carry out business strategy or structure business deals in certain ways.”**

#### Growth stage followed by post-commitment or divestment

During this period you'll hold and liquidate the fund's investments. This doesn't happen all at once. Rather, there are a series of liquidations over the course of several years. The divestment period can last from four to seven years after the end of the investment phase.

---

**CT Tip:** *During the lifetime of the entity through which the fund is operating, compliance with the state business entity statute is required to maintain good standing. Depending upon the entity type and state, this could include filing an annual report with the state business entity filing office and paying franchise taxes.*

CT offers a compliance bundle, which combines registered agent and annual report service fees for all statutory appointments and includes applicable Delaware franchise taxes on one invoice, by entity or by group of entities. All entities are kept in full compliance with fewer invoices to review and reconcile.

Filings may also be required upon certain changes, such as a name change or change of Registered Agent/office, merger, or conversion. If the fund is doing business in states outside of its state of formation, qualification to do business in those states may be required.

*continued on page 3*

### Term extensions

Many limited partnership agreements allow the fund manager to extend the term of the fund for a limited period.

---

**CT Tip:** *If a term limitation is set forth in the certificate of limited partnership as well as the partnership agreement, you may need to file an amendment to that certificate with the state.*

### Dissolution and liquidation

At the end of the post-commitment period, unless the fund's term is extended, the fund will be dissolved.

---

**CT Tip:** *If the entity through which the fund is owned and operated (such as a limited partnership or LLC) is to be dissolved, there are various tasks that should be completed. The statutory procedure of the formation state's business entity statute must be complied with and a cancellation of the certificate of limited partnership, or other entity formation document, will have to be filed. Licenses and permits will need to be cancelled, and taxes will have to be paid. And, there may be other requirements with the bank, investors, or at the federal level.*

Formal entity dissolution is critical to reducing potential liabilities, such as business identity theft.

### COMPLIANCE MISSTEPS CAN BE COSTLY

There are many pitfalls to navigate, and compliance missteps can result in fines, damaged reputation, and an inability to carry out business strategy or structure business deals in certain ways. Non-compliance can also jeopardize the ability to attract investors or lead to loss of a deal.

For instance, failing to properly dissolve an entity pursuant to its business entity statute can lead to the risk of commercial or corporate identity theft, which can [result in financial liabilities](#). Businesses that are not formally dissolved also risk sanctions from states. A failure to satisfy corporate or LLC filing requirements, taxes, etc. may result in additional fines or penalties. To add further complexity, compliance requirements can also vary by state.

Given these considerations, it's important to find a trusted partner to guide you when navigating the funds and alternative investments compliance landscape. A partner that can remain independent between the lender and borrower —

as well as being experienced and knowledgeable in their industry.

### BEST PRACTICES FOR DEVELOPING A COMPLIANCE STRATEGY

As your firm develops its compliance strategy, consider the following best practices.

1. Have a way to stay up to date on the fiduciary, regulatory, and statutory responsibilities of a business entity and its directors, officers, managers, and partners. You should also actively maintain and manage the corporate record to support all transactions, filings, reports, and audits.
2. Employ a best-in-class, centralized entity/subsidiary platform to help with these tasks so you can stay ahead of all compliance requirements at the local, state, federal, and global level. With a single, secure source of current entity data, you can easily find, update, and share corporate records across your organization. And you can implement such a solution cost-effectively and without disruption to day-to-day business.
3. Another important aspect of your compliance strategy is right sourcing. As midmarket private equity firms and their portfolio companies grow and expand to new areas, compliance responsibilities can increase exponentially. These time-consuming duties can often sneak up on firms and sap energy and divert resources from the firm's strategic goals.

Firms are presented with a choice. They can hire attorneys, paralegals, and administrative staff in-house, which increases overhead and requires a fair amount of management's time. Or they can make more effective use of right-sourcing strategies. For instance, shifting to outsource providers or utility-like platforms where key skills of geographic coverage can be provided more cost-effectively — outside the firm.

There are also many aspects of governance that can benefit from the expertise that comes from consultants and managed service providers, particularly in the field of compliance.

### THE IMPACT OF COVID-19

While the pandemic has disrupted the investment industry in the short-term, the long-term outlook is positive. According to [Preqin](#), at the current time, 58% of investors are decreasing their planned number of new commitments in 2020 and

*[continued on page 4](#)*

This information is not intended to provide legal advice or serve as a substitute for legal research to address specific situations.

59% are decreasing the planned size. As a result, fund managers are feeling the impact. Of those with funds open to investment, 55% have slowed their fundraising process, while 1% have abandoned it entirely.

But in the longer term, the expected impact is more positive. Significant proportions of both fund managers and investors expect COVID-19 to have a slightly negative long-term impact on returns. But most investors say that the pandemic will have no impact on how much they invest in alternatives, and 29% plan to invest more as a result. More than 60% of fund managers, meanwhile, say that COVID-19 has not affected the targeted returns of their funds in market, and 75% say that they will not adjust their investment strategy as a result of the pandemic.

In addition, there is significant opportunity to provide investment and financing to distressed companies, and

private equity firms can provide capital for businesses that lack access to traditional financing.

Importantly, this market volatility highlights the need to have a compliance strategy in place.

### CONCLUSION

Investment management firms are facing significant upheaval. Economic and regulatory changes are quickly shifting the future of the asset management industry. Robust compliance measures are imperative at this time to help ensure firms capture opportunities and mitigate risk.

When it comes to closing a deal, there are moving pieces, and complex compliance issues you have to navigate. CT offers [Deal Support Solutions](#) to ensure that the complex and sensitive work you deal with is manageable, accurate, and on time.