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# Final Private Fund Rules: Key Compliance Challenges and Next Steps (Part Two of Two)

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Genna Garver

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Genna Garver, a partner in Troutman Pepper's Corporate Practice Group, was quoted in the September 28, 2023 *Hedge Fund Law Report* article, "Final Private Fund Rules: Key Compliance Challenges and Next Steps (Part Two of Two)."

"I think we were all surprised. [The Rules] are a far cry from the Proposal," agreed Troutman Pepper partner Genna Garver.

The relatively favorable provisions in the Rules are likely due to the substantial comments offered on the Proposal by the private funds industry. "The pressure from the industry was successful in many ways in getting the Proposal changed – more so than I can remember for recent rulemaking," said Daniel Bresler, partner at Seward & Kissel. Echoing that point, Garver noted that "the biggest thematic change is moving from a prescriptive, prohibited approach to a more disclosure-based, restricted approach, which clearly was in response to significant, overwhelming industry comment."

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"I certainly have concerns about [the compliance deadlines] for a number of reasons, one being general regulatory fatigue. We've been drinking from a regulatory firehose – it has not stopped. We still have a number of significant proposals on the docket and more to be proposed," agreed Garver, who added that "the Rules are not clear in all respects, and that takes time to think through."

"How much time would be enough? I don't know. If this was the only thing that we had going on, then maybe we could get a better sense of exactly how long it would take," continued Garver. "The reality is, in addition to the regulatory burden, there have been some significant market developments. I am personally very concerned about the bandwidth for compliance programs to meet the needs under the current rules, handle exams and prepare for the Rules."

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"Cataloging all preferential treatment is going to be a challenge. In fact, this might be one of the most challenging compliance tasks at hand," Garver commented. "The Rule isn't just about side letters, and that's really critical. If you don't have any side letters in your fund, you still need to comply with these restrictions," she explained. "It's any term – regardless of how and where it is memorialized – that distinguishes one investor from another investor

in the same product," Gutman clarified.

For example, if a fund manager waived a required notice period and allowed an investor to give notice 20 days before redeeming instead of 60 days, that preferential liquidity would arguably trigger the Rule's requirements, continued Garver. "Managers are always reviewed or questioned with the benefit of hindsight. So, even if at the moment it may not look like you're giving preferential liquidity, you need to carefully think through how it could play out, especially during a liquidity crunch," she explained. "It'll be difficult to waive any requirement for one investor and not waive it for all. And, do you have to let everyone know you're going to waive a requirement for an investor so if anyone else wants to join in, they can? There are still sticky scenarios to work through."

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Moreover, the lack of additional guidance may result in deficiency letters and even enforcement actions. "There will be a lot of interpretive issues and line-drawing exercises, and reasonable people can come to different conclusions," Koffler predicted. "If you go in one direction and it turns out the staff expected firms to go in a different direction – but didn't indicate that in any way – then that's a 'gotcha.' And what's the value of going after a firm in that situation? There is none." Garver agreed, characterizing the Rules as essentially "tripwires."

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Moreover, the costs of complying with various new rules at the same time must be viewed in the aggregate. "Costs cannot be viewed in a vacuum. The aggregate rulemaking has a huge impact on time, attention and budget," Garver stressed.

Although compliance costs are an issue for all fund managers, those costs will be a big lift for emerging managers. "If you're talking about funds at an early stage, their budgets are critical to sustaining their operations," shared Garver. Gutman added, "That's why the Rules are viewed as another barrier to entry because it will be expensive and time consuming to become compliant. As more burdens are imposed on the industry, it's harder to launch a new manager and a new fund."

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"Take the time to understand the Rules and how they apply to your business," agreed Garver. "It's not enough to look at the Rules in a vacuum, however. You also need an understanding of your documents and what's currently permissible under them." Given the flurry of recent SEC rulemaking, she advised CCOs to ensure they have command of requirements:

- that are currently in place;
- that are about to go in effect, such as the Form PF current reporting requirements; and
- that will go take effect in 12?18 months.

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“Often when a new rule comes out, managers will update their policies and procedures in ways that just regurgitate the rule. What we’ve seen on exams regarding the Marketing Rule, however, is that the SEC is really interested in the rule implementation process,” Garver shared. “That’s why you must take time to understand the Rules and how they apply to your specific business and your documents. Then, ensure you document your implementation process as you amend your policies and procedures.”

It is also important to identify where your fund documents and the Rules conflict or intersect. “The conditions placed on restricted activities may be different than the policies and procedures the manager has in place today. For example, a PE fund may use a limited partner advisory committee (LPAC) to clear certain conflicts or approve certain activities,” Garver observed. “The Rules call into question whether an LPAC could serve as the gatekeeper for restricted activities, however. If a PE fund requires LPAC approval to charge certain expenses to the fund and the Rules require another control mechanism, you would effectively have to comply with both paths to engage in those activities.”

“The bottom line is that although you can agree to have more restrictive provisions or additional controls and bells and whistles, the SEC is prescribing a certain path to compliance,” continued Garver. “This could create additional work for managers that may already have sufficient controls in place that were tailored to their business.”

Once policies and procedures have been updated to reflect the Rules’ requirements, compliance needs to follow those policies and procedures on an ongoing basis, test them, train employees on them and create sufficient documentation to substantiate their compliance upon exam, Garver added.

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