

Hedge Funds – Potential Exemptions from Registration*

Authority	Applies To	Requirements to Avoid Registration ¹	
		Ownership	Activities
33 Act: §4(2) Exempt Transaction Outcome can be uncertain	Fund Shares SEC	Offering must pass a subjective evaluation based on a variety of criteria that include: <ul style="list-style-type: none"> - Number of offerees (<i>not</i> investors) - Sophistication of the offerees - Offeree access to adequate disclosure information - Offerees are financially able to bear the risks 	Cannot involve any “public offering” based on a judgment reflecting a variety of factors outlined in case law ² and SEC guidance, as summarized in column to the left
Reg D: Rule 506 Exempt Transaction Non-exclusive safe harbor under §4(2) of the 33 Act Note Rule 504 and Rule 505 for exemptions with offering size limits	Fund Shares SEC	Any number who are <i>Accredited Investors</i> at the time of purchase (Rule 501(a): most institutions –and– individuals with \$1M net worth [with spouse] <u>or</u> income of \$200K [\$300k with spouse] in past two years and reasonable expectation of doing so again in the current year) ≤ 35 over the life of fund ³ who were <i>Non-Accredited Investors</i> at time of purchase, who must have sufficient knowledge, experience and information about the offering to evaluate its merits and risks Institutions must meet asset requirements that are based on their form and purpose. Directors, general partners and executive officers of the hedge fund or its general partner	File Form D with the SEC within 15 days of first sale No dollar limit on sales No <i>general</i> solicitation or advertising permitted, including via articles, notices, interviews, the Internet, and seminars; in practice must pre-screen before making a solicitation Disclosure to Non-Accredited investors must parallel that in a registered offering; in practice, if disclose to them should also provide same information to Accredited Investors Reasonable care must be taken to ensure investors do not resell shares, including legends on any certificates, advanced disclosures, and inquiries concerning the intent of potential buyers
§34 Act: §12(g)	Fund Shares SEC	< 500 investors at all times during the life of the fund	
Advisers Act: §203(b)(3) Investment Adviser	Investment Adviser SEC	< 15 investors; where the hedge fund is interpreted as one investor <i>per Goldstein</i> ⁴ (but this would be <u>subject to the SEC’s reinterpretation under pending Financial Regulatory Reform legislation</u>) Advisers with less than \$25M under management may be required to register with the States where they do business	Cannot generally hold the adviser out to the public as an investment adviser (the restriction is interpreted broadly) or advise registered investment companies Can charge performance fees only from <i>Qualified Clients</i> (Rule 205-3: at least \$1.5M net worth and \$750K managed by the adviser)
Commodities Exchange Act: §4.14(a)(10) Commodity Trading Adviser	Investment Adviser CFTC NFA	≤ 15 investors; limited partnerships (like a hedge fund) that are advised on the basis of the partnerships’ objectives not the individual owners’ objectives, are treated as single investors	Cannot publicly hold the adviser out as a CTA Must disclose reliance on this exemption to investors

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40 Act: §3(c)(1) Investment Company	Hedge Fund SEC	<p>≤ 100 beneficial owners³, not counting knowledgeable employees</p> <p><i>Knowledgeable Employees</i>, including executive directors, trustees, general partners, and professionals engaged in managing money for the fund</p>	<p>Cannot make or propose at the time of sale to make a public offering</p> <p>Must disclose reliance on this exemption to offerees</p>
40 Act: §3(c)(7) Investment Company	Hedge Fund SEC	<p>Restricted to those reasonably believed to be <i>Qualified Purchasers</i> at time of each purchase (at least \$5M personal / \$25M institutional investments), plus</p> <p><i>Knowledgeable Employees</i> and affiliated persons of the fund</p>	<p>Cannot make or propose at the time of sale to make a public offering</p>
Commodities Exchange Act: §4.13(a)(3) Commodity Pool Operator	Hedge Fund CFTC NFA	<p>Qualifies for exemption under the 33 Act</p> <p>Reasonably believes that at time of purchase all investors are:</p> <ul style="list-style-type: none"> - <i>Accredited Investors</i> under Reg D, or - <i>Knowledgeable Employees</i> and affiliated persons of the fund under the 40 Act, or - <i>Qualified Eligible Persons</i> (CFTC Rule 4.7(a)(2): <i>Qualified Purchasers</i> under the 40 Act and certain employees, agents and affiliates of the adviser) 	<p>File notice with NFA before deliver subscription agreements</p> <p>The fund's initial commodity margin and premiums are less than 5% of the position liquidation value, <u>or</u> the liquidation value of the fund's commodity positions does not exceed the value of the total portfolio</p> <p>Cannot hold the fund out generally as a commodity pool operator, or as a vehicle for trading in commodity futures or options</p> <p>Must disclose reliance on this exemption to offerees</p> <p>Also exempt if registered with the SEC as an Investment Company</p>
Commodities Exchange Act: §4.13(a)(4) Commodity Pool Operator	Hedge Fund CFTC NFA	<p>Qualifies for exemption under the 33 Act</p> <p>Reasonably believes at time of purchase that all investing:</p> <ul style="list-style-type: none"> - <u>Individuals</u> are <i>Qualified Eligible Persons</i> - <u>Institutions</u> are either <i>Accredited Investors</i> under Reg D, or - <i>Qualified Eligible Persons</i> 	<p>File notice with NFA before deliver subscription agreements</p> <p>Cannot hold the fund out generally as a commodity pool operator</p> <p>Must disclose reliance on this exemption to offerees</p> <p>Also exempt if registered with the SEC as an Investment Company</p>

¹ This table does not address offshore funds or foreign investors in domestic funds.

² See for example, *S.E.C. v. Ralston Purina Company*, 346 U. S. 119 (1953).

³ There is the potential under Rule 502(a) of the Advisers Act and §3(c)(1) of the 40 Act for integrating multiple offerings for purposes of determining the number of owners under the respective exemptions, where the determination is made based on a series of factors; there is a safe harbor under Rule 502 for offerings separated by 6 months or more.

⁴ *Goldstein v. SEC*, 451 F.3d 873 (D.C. Cir. 2006).