

PRESENTATION TO ISRAEL HEDGE FUNDS ASSOCIATION MEMBERS

## **Marketing and Distributing Your Fund in the United States: U.S. and Israel Legal and Regulatory Considerations**

November 11, 2020

---

### PRESENTERS:

**Wendy E. Cohen**, Co-Chair, Investment  
Management and Funds, Katten

**David Y. Dickstein**, Partner, Financial Markets  
and Funds, Katten

# **U.S. Regulatory Considerations when Offering Fund Interests to U.S. Persons**

# **Investment Adviser Registration Considerations**

# The Investment Advisers Act of 1940

- The Investment Advisers Act of 1940 (“Advisers Act”) defines an Investment Adviser as any person or firm that:
  - for compensation;
  - is engaged in the business of;
  - providing advice to others or issuing reports or analyses regarding securities.
- A person or firm that falls under the Investment Adviser definition needs to register with the US Securities and Exchange Commission (SEC) under the Advisers Act absent an applicable exemption.



# Foreign Private Fund Adviser Exemption

- **Foreign Private Fund Advisers.** A manager based abroad may qualify as a “foreign private fund adviser,” which is a self-executing exemption not subject to SEC regulation and does not need to file any reports with the SEC, if it:
  - has no place of business in the United States;
  - has fewer than 15 clients in the United States and US investors in private funds it advises;
  - has aggregate assets under management, attributable to such US clients and investors, of less than USD 25 million; and
  - neither holds itself out to the public in the United States as an investment adviser, nor acts as an investment adviser to any registered investment company or business development company.

# Private Fund Adviser Exemption

- **Private Fund Advisers.** Under the private fund adviser exemption, a non-US investment adviser will be exempt from Advisers Act registration if:
  - The adviser has no client that is a US person other than one or more qualifying private funds;
  - All assets managed by the investment adviser at a place of business in the United States are solely attributable to private funds, the total value of which is less than USD 150 million.
    - Where funds are exclusively managed outside the United States this limitation will not apply.
  - A private fund adviser must electronically file with the SEC public reports on Part 1A of Form ADV annually within 90 days of an adviser's fiscal year end.

# Foreign Private Fund Adviser v. Private Fund Adviser

|                                | Foreign Private Fund Adviser   | Private Fund Adviser   |
|--------------------------------|--|--|
| <b>Number of US Clients</b>    | 15 or fewer US clients or investors in a managed fund  | No U.S clients other than qualifying private funds, but no limitation on the amount of investors in the fund     |
| <b>US Place of Business</b>    | No place of business in US   | If place of business in US, assets managed in US are limited to USD 150 million                                  |
| <b>AUM Restrictions</b>        | Aggregate assets under management, attributable to US clients and investors, of less than USD 25 million | No limitation on assets under management attributable to US clients and investors if no place of business in US. |
| <b>SEC Filing Requirements</b> | No registration, reporting, or recordkeeping requirements  | Must annually file Part 1A of Form ADV with the SEC  |

# Regulation D Private Placement Offerings



# The Securities Act of 1933

- The US Securities Act of 1933 (the Securities Act), regulates the offer and sale of “securities,” including investor interests in private funds.
- Under the Securities Act, offers and sales of securities must either be:
  - registered with the SEC; or
  - offered and sold in compliance with an applicable exemption from registration.



# Regulation D – Rule 506

- **Regulation D.** Most private funds marketing in the United States typically rely on the private placement exemption contained in Section 4(a)(2) of the Securities Act and, in particular, the nonexclusive safe harbor exemption from registration provided by Rule 506(b) & (c) of Regulation D under the Securities Act.
- Rules 506(b) and 506(c) of Regulation D allow issuers to privately place an unlimited number of securities, subject to certain restrictions and requirements.



# Rule 506(b) v. Rule 506(c)

|                                | Rule 506(b)   | Rule 506(c)   |
|--------------------------------|---|---|
| <b>General Solicitation</b>    | <u>No</u> general solicitation or general advertising   | <u>May use</u> general solicitation or general advertising  |
| <b>Investor Requirements</b>   | Unlimited number of "accredited investors" and up to 35 other "sophisticated investors"   | <u>Exclusively</u> to "accredited investors" and must <u>confirm status</u> of investors  |
| <b>Restrictions on Resale</b>  | No resale within 6 months   | No resale within 6 months   |
| <b>Issuer Requirements</b>     | No "Bad actor" disqualification events  | No "Bad actor" disqualification events  |
| <b>SEC Filing Requirements</b> | File with the SEC an online, publicly available notice on Form D no later than 15 days after the date of the first sale of securities | File with the SEC an online, publicly available notice on Form D no later than 15 days after the date of the first sale of securities |

# Accredited Investors

- **Accredited Investors Defined.** An accredited investor is defined as:
  - A natural person with earned income that exceeded USD 200,000 (or USD 300,000 together with a spouse) in each of the prior two years, and reasonably expects the same for the current year;
  - A natural person who has a net worth over USD 1 million, either alone or together with a spouse (excluding the value of the person’s primary residence); or
  - Entities that have total assets in excess of USD 5 million.
- In December 2020, SEC amendments to the “accredited investor” definition will become effective allowing more investors to participate in private offerings by adding new categories of individuals who may qualify as accredited investors including:
  - “Knowledgeable employees” of a private fund;
  - Individuals with Series 7, 65 or 85 Certifications; and
  - “Spousal equivalents” - cohabitants meeting the spousal earned income requirement who have a relationship generally equivalent to marriage.

# **Investment Company Act of 1940 Section 3(c)(1) and 3(c)(7) Exemptions**

# The Investment Company Act of 1940

- The Investment Company Act of 1940 (the Investment Company Act), regulates the activities of “investment companies” that are, broadly speaking, entities that are engaged in the business of “investing, reinvesting, owning, holding or trading in securities” or that hold themselves out as doing such.
- Private funds are structured avoid “investment company” status through relying on one of two exclusions, Section 3(c)(7) or Section 3(c)(1), under the Investment Company Act.

# Section 3(c)(1) v. Section 3(c)(7)

|   | Section 3(c)(1)  | Section 3(c)(7)   |
|---|--|---|
| <b>Public Offering</b>                  | No public offerings  | No public offerings   |
| <b>Number of Investors</b>              | Fewer than <u>100</u> beneficial owners (or 250 if the fund is a qualifying venture capital fund)  | <u>Unlimited</u> number of investors.   |
| <b>Investor Requirements</b>            | Investors must: (i) meet the definition of “ <u>accredited investor</u> ” under a Rule 506(c) offering; or (ii) be either an “ <u>accredited investor</u> ” or one of 35 allowable “ <u>sophisticated investors</u> ” under a Rule 506(b) offering | Investors must be “ <u>qualified purchasers</u> ” (Investment portfolio of <u>at least: USD 5 million</u> for individuals and <u>USD 25 million</u> for entities) |
| <b>Knowledgeable Employee Exception</b> | “knowledgeable employees” of the fund’s investment manager are excluded from the beneficial owner count  | “knowledgeable employees” of the fund’s investment manager are excluded from the qualified purchaser requirement  |

# State Blue Sky Considerations



# Blue Sky Laws

- **State Blue Sky Laws.** In addition to the US federal securities laws, a fund may have to comply with selected state securities laws (or “Blue Sky” laws) which could require notice filings and corresponding filing fees with state authorities depending on the jurisdictions in which the sales of interests are made (usually the states of the US investors’ principal place of business or residence).
- In many cases the “notice filings” require the filing of a Form D with the relevant state regulator simultaneously to filing with the SEC.



# Disclosures and Subscription Documents

# Disclosures

- A foreign-organized fund has the choice of creating a separate US fund for US investors or offering the foreign fund exclusively to tax-exempt investors through an offering memorandum supplement.
- Additional information that would need to be provided to US investors would include:
  - That the fund is: (1) exempt from registration under the Securities Act and Investment Company Act; and (2) what exemptions it is relying on
  - Blue Sky disclosures
  - Tax considerations for US investors
  - Specific risks applicable to US investors (e.g. if investing in a foreign currency that will need to be converted into USD)

# Content of Subscription Documents

- The Subscription Documents should include:
  - Accredited Investor Questionnaires
    - Through which a subscriber confirms that it qualifies as an “accredited investor” for purposes of Rule 506(b) or (c) (or the relevant “sophisticated investor” requirements under 506(b)) and Section 3(c)(1) of the Investment Company Act.
  - Qualified Purchaser Questionnaires
    - Through which a subscriber represents that it qualifies as a “qualified purchaser” for purposes of Section 3(c)(7) of the Investment Company Act.
  - Restricted Person Information
    - Under FINRA Rules 5130 and 5131, the fund would be precluded from participating in IPOs if certain beneficial owners of the fund are “restricted persons” as defined by those rules.
  - Anti-Money Laundering (AML) Representations
    - Where a subscriber represents that no part of the funds used by the subscriber to make its capital contribution or other payments to the fund was directly derived from activities that violate AML requirements.

# Use of Marketers

# Broker-Dealer Rules

- Under the Securities Exchange Act of 1934 (the “Exchange Act”), placement agents, finders, and similar service providers that are compensated for raising capital generally are required to be registered as “broker-dealers” with the SEC.
- The broker-dealer requirements apply both to the individuals who engage in capital raising as well as the funds that employ them.
- Failure to comply with such requirements could result in the imposition of sanctions on a fund or its employees, and could give purchasers of interests the right to rescind their investment.

# Issuer Exemption

- **Issuer Exemption.** Employees of a fund manager who sell interests in the manager's private funds may rely on an exemption under Exchange Act Rule 3a4-1 that provides an associated person (or employee) of an issuer who participates in the sale of the issuer's securities would not have to register as a broker-dealer if that person:
  - (1) is not subject to a "statutory disqualification," by a final order of a relevant regulator;
  - (2) is not compensated by payment of commissions or other remuneration based directly or indirectly on securities transactions;
  - (3) is not an associated person of a broker or dealer; and
  - (4) limits its sales activities
  - (5) must have substantial other duties in addition to marketing securities

# The Proposed Exemption for Finders

- On October 7, 2020, the SEC issued a Proposed Exemptive Order that would exempt from broker-dealer registration two classes of “finders”
  - “Finders” are someone who puts potential buyers and sellers of securities in contact with one another for a fee
- If adopted as proposed, this exemption would allow issuers (such as private funds) to hire third parties to assist with fundraising from accredited investors and to pay transaction-based compensation.
- Two levels of finders would be exempted:
  - Where the finder’s activity is limited to providing investor contact information to an issuer once a year and no contact is made with an investor, minimal requirements would be necessary
  - Where the finder engages directly with investors, the activity could be conducted following a written disclosure to potential investors including compensation information and other important information





# Privacy Requirements

# Privacy and Information Security

- The Gramm-Leach-Bliley Act governs the use of nonpublic information of natural person investors and the implementation of administrative, technical and physical safeguards to protect such information.
- Funds and their managers are required to:
  - (1) have policies and procedures regarding the safeguarding and use of investor's private information; and
  - (2) send notices that describe those policies on an initial and sometimes annual basis.



# Speaker Information



***Wendy E. Cohen***

**Katten**

Partner and Co-Chair, Investment  
Management and Funds

wendy.cohen@katten.com

New York

T +1.212.940.3846



***David Y. Dickstein***

**Katten**

Partner, Financial Markets and  
Funds

david.dickstein@katten.com

New York

T +1.212.940.8506

# Wendy E. Cohen



**Katten**

**Partner and Co-Chair,  
Investment Management and  
Funds**

wendy.cohen@katten.com

New York

T +1.212.940.3846

Wendy Cohen, co-chair of the Investment Management and Funds group, understands the business realities and challenges of the competitive world of asset management. For three decades, asset managers have turned to her to navigate the minefield of regulation that governs the structuring and operation of private investment funds. From the largest and most established hedge funds to innovative players with alternative strategies, clients rely on Wendy to handle all legal issues that touch their businesses.

Wendy knows that asset managers don't fit a single mold. She understands each of her client's businesses, and uses that understanding to suggest practical strategies that are commercial while minimizing the risk of regulatory violations. Those clients have rewarded her with their loyalty. In an industry where personal connections matter, Wendy forges fast and long-standing relationships with clients large and small.

Wendy has amassed extensive knowledge on the laws most relevant to her client base of private investment funds whether the investment portfolio includes securities, futures or cryptocurrencies. She has particular experience on issues relating to the formation and ongoing operation of fund management, including domestic and offshore offering requirements, futures regulation, investment adviser rules and broker-dealer regulation. She also stays in front of new and changing legal issues that touch other aspects of fund operations — among them cryptocurrencies, cybersecurity rules, US and EU privacy regulations and ERISA-related matters.

## **Education**

- JD, New York University School of Law
- BA, University of Pennsylvania, *magna cum laude*

# David Y. Dickstein



**Katten**

**Partner, Financial Markets and  
Funds**

david.dickstein@katten.com

New York

T +1.212.940.8506

David Dickstein addresses a wide range of regulatory and compliance issues for investment advisers, hedge and private equity funds.

David regularly counsels investment advisers on matters such as the need for registration, Form ADV matters, disclosing conflicts of interest, compliance policies and procedures, rules on personal trading, marketing materials and federal and state pay-to-play and lobbying registration matters. Clients also frequently seek David's assistance with SEC examinations.

David also advises brokerage and advisory firms on soft dollars and best execution, wrap-fee programs, trade allocations, marketing arrangements and bad actor matters. In addition, he conducts compliance audits and provides advice on SEC investigations.

## Education

- JD, Columbia Law School
- BA, Yeshiva University, *magna cum laude*

# Katten Locations

## **CHARLOTTE**

550 South Tryon Street  
Suite 2900  
Charlotte, NC 28202-4213  
+1.704.444.2000 tel  
+1.704.444.2050 fax

## **CHICAGO**

525 West Monroe Street  
Chicago, IL 60661-3693  
+1.312.902.5200 tel  
+1.312.902.1061 fax

## **DALLAS**

2121 North Pearl Street  
Suite 1100  
Dallas, TX 75201-2494  
+1.214.765.3600 tel  
+1.214.765.3602 fax

## **LONDON**

Paternoster House  
65 St Paul's Churchyard  
London EC4M 8AB  
United Kingdom  
+44 (0) 20 7776 7620 tel  
+44 (0) 20 7776 7621 fax

## **LOS ANGELES – CENTURY CITY**

2029 Century Park East  
Suite 2600  
Los Angeles, CA 90067-3012  
+1.310.788.4400 tel  
+1.310.788.4471 fax

## **LOS ANGELES – DOWNTOWN**

515 South Flower Street  
Suite 4150  
Los Angeles, CA 90071-2212  
+1.213.443.9000 tel  
+1.213.443.9001 fax

## **NEW YORK**

575 Madison Avenue  
New York, NY 10022-2585  
+1.212.940.8800 tel  
+1.212.940.8776 fax

## **ORANGE COUNTY**

100 Spectrum Center Drive  
Suite 1050  
Irvine, CA 92618-4960  
+1.714.966.6819 tel  
+1.714.966.6821 fax

## **SHANGHAI**

Suite 4906 Wheelock Square  
1717 Nanjing Road West  
Shanghai 200040  
P.R. China  
+86.21.6039.3222 tel  
+86.21.6039.3223 fax

## **WASHINGTON, DC**

2900 K Street NW  
North Tower - Suite 200  
Washington, DC 20007-5118  
+1.202.625.3500 tel  
+1.202.298.7570 fax

Katten refers to Katten Muchin Rosenman LLP and the affiliated partnership as explained at [katten.com/disclaimer](http://katten.com/disclaimer).

Attorney advertising. Published as a source of information only. The material contained herein is not to be construed as legal advice or opinion.