

DuaneMorris

Investment Company Act of 1940 Private Funds

David A. Sussman

Steven J. Gray

March 2016

©2016 Duane Morris LLP. All Rights Reserved. Duane Morris is a registered service mark of Duane Morris LLP.

Duane Morris – Firm Offices | New York | London | Singapore | Philadelphia | Chicago | Washington, D.C. | San Francisco | Silicon Valley | San Diego | Shanghai | Boston | Houston | Los Angeles | Hanoi | Ho Chi Minh City | Atlanta | Baltimore | Wilmington | Miami | Boca Raton | Pittsburgh | Newark | Las Vegas | Cherry Hill | Lake Tahoe | Myanmar | Oman | Duane Morris – Affiliate Offices | Mexico City | Sri Lanka | Duane Morris LLP – A Delaware limited liability partnership

www.duanemorris.com

Investment Company Act of 1940

- The Investment Company Act of 1940 (“1940 Act”) regulates “investment companies,” *i.e.*, entities engaged primarily in the business of investing and reinvesting in securities
- The 1940 Act requires investment companies to register with the SEC and imposes extensive substantive regulations on registered entities, including:
 - Independent boards of directors
 - Investment and leverage restrictions
 - Extensive investor disclosure and SEC filing requirements
 - Limits on length and terms of management contracts
 - Restrictions on related party transactions
- Private funds avoid burdensome restrictions by qualifying for an exception from registration
- The exceptions most relied upon for private equity and hedge funds are:
 - Section 3(c)(1)—Private investor funds
 - Section 3(c)(7)—Qualified purchaser funds

3(c)(1) Funds

- Section 3(c)(1) exception is available to any fund:
 - whose outstanding securities are beneficially owned by fewer than 100 persons, and
 - does not make a public offering of its securities
- Ownership applies to all securities, whether debt or equity, voting or non-voting (other than short term paper)
- Special counting rules:
 - Fund interests jointly owned by spouses treated as having one beneficial owner
 - Fund interests owned in spouses' own names counted separately
 - No double counting if the same person holds through different investment vehicles
 - “Knowledgeable Employees” not counted toward limit:
 - Executive officers, directors and similar senior-level personnel
 - Employees and affiliates of the fund who participate in the investment activities of the fund
 - A company is treated as a single holder, unless:
 - The company holds 10% or more of the voting securities of the fund and is an investment company or itself a 3(c)(1) or 3(c)(7) fund
 - Ownership is then attributed to all the company's securities holders, who must be separately counted toward the 100 person limit
- 3(c)(1) funds are permitted to pay performance fees to registered investment advisers only if all investors are “qualified clients” under the Investment Advisers Act (e.g., have a net worth of at least \$2,000,000, etc.)
- Fund offerings must be conducted under Regulation D or Rule 144A of the Securities Act

3(c)(7) Funds

- Section 3(c)(7) exception is available to any fund:
 - whose securities are owned exclusively by “qualified purchasers”
 - does not make a public offering of its securities
- Qualified purchasers include:
 - Natural persons with not less than \$5,000,000 in investments
 - Family companies with not less than \$5,000,000 in investments
 - Trusts if trustees and settlors are qualified purchasers
 - Companies with not less than \$25,000,000 in investments
 - Companies owned solely by qualified purchasers
 - Qualified institutional buyers (QIBs) under Rule 144A
 - “Knowledgeable Employees”
 - Executive officers, directors and similar senior-level personnel
 - Employees and affiliates of the fund who participate in the investment activities of the fund
- No limit on number of qualified purchasers or percentage ownership
- 3(c)(7) funds are permitted to pay performance fees to registered investment advisers
- Fund offerings must be conducted under Regulation D or Rule 144A of the Securities Act

Further Information

David Sussman, Partner, Newark
dasussman@duanemorris.com
+1 (973) 424-2011

Steven J. Gray, Partner, Chicago
sjgray@duanemorris.com
+1 (312) 499-0112

DuaneMorris

Investment Company Act of 1940 Private Funds

David A. Sussman

Steven J. Gray

March 2016

©2016 Duane Morris LLP. All Rights Reserved. Duane Morris is a registered service mark of Duane Morris LLP.

Duane Morris – Firm Offices | New York | London | Singapore | Philadelphia | Chicago | Washington, D.C. | San Francisco | Silicon Valley | San Diego | Shanghai | Boston | Houston | Los Angeles | Hanoi | Ho Chi Minh City | Atlanta | Baltimore | Wilmington | Miami | Boca Raton | Pittsburgh | Newark | Las Vegas | Cherry Hill | Lake Tahoe | Myanmar | Oman | Duane Morris – Affiliate Offices | Mexico City | Sri Lanka | Duane Morris LLP – A Delaware limited liability partnership

www.duanemorris.com