



RANDALL & ASSOCIATES

SECURITIES & CAPITAL MARKETS LAW

Legal Documents & Filings To Start An Investment Fund

FORMATION, OFFERING DOCUMENTS & REGULATORY FILINGS

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Starting an investment fund can seem like a never ending puzzle of legal and regulatory requirements. This white paper discusses some of the key structural considerations, legal documents and required filings involved in starting a fund. The term “fund” covers a broad spectrum of either (i) *open-ended funds* (i.e. hedge funds) or (ii) *closed-ended funds* (i.e. private equity or real estate). A properly created fund will provide for a tax efficient structure, meet the required statutory (SEC & Blue-Sky) requirements or exemptions, make proper risk and other securities disclosures and set market-appropriate terms to raise and deploy capital.

The structure of an investment fund is dependent on a number of tax, regulatory, and financial considerations. Fund structure is driven in large part by the tax needs of the investors. It is critical to consult experienced counsel when starting a investment fund.

FORMATION DOCUMENTS

Creating The Entities For The Fund

The formation documents for a fund are the documents that are filed with the appropriate government authority to create the business entities of the fund, typically the fund itself, the general partner and the investment management company. These newly formed entities could include limited partnerships (LP's), limited liability companies (LLC's), or corporations. Most of the investment funds involve a limited partnership with a general partner being the sponsor and the investors are limited partners. Choice of entity has considerable tax and liability implications so the decision on entity type should be made carefully.

Fund Structure Considerations

There are many factors to consider when deciding on what type of entity and structure is best for a fund. Here are some of the most common: (1) Is the fund an open-ended or closed-end fund? (2) What exemption from the Investment Company Act are you relying on? (3) Are you taking investment from U.S. investors only, or will there be foreign investors? (4) What types of investors will be investing in the fund? (5) Are you going to solicit investment from potential investors publicly?

"When creating a fund, choice of entity has considerable tax and liability implications for fund sponsors and potential investors."

THE OFFERING DOCUMENTS

The offering documents are the documents that may be given to a potential investor prior to investing. These may include:

- A disclosure document call a private placement memorandum ("**PPM**"). Not all funds require a PPM but are advised to disclose risk and important fund information.
- The governing documents for the fund. This could be a limited partnership agreement or operating agreement (depending on whether the fund is formed as a limited partnership or LLC)
- Investment purchase documents in the form of a subscription agreement and investor questionnaire.

Considerable thought and care should be taken when drafting the initial offering documents, especially any PPM or "Pitch Deck" to be sure investment risk is disclosed properly and thoroughly.

"A properly prepared PPM should protect a fund sponsor from investor claims of non-disclosure."

Private Placement Memorandums

As previously mentioned, a private placement memorandum (PPM) is a securities disclosure document provided to potential investors. A PPM provides investors with material information about the fund in order to allow the investor to make an educated and informed decision about making an investment.

A PPM is similar to a prospectus which is provided to investors in a public offering typically traded on a public exchange. The PPM provides potential investors with specific and detailed information about the investment terms of the fund, the structure of the fund, the background and experience of the fund managers, and the risks associated with the specific investments made by the fund.

Limited Partnership Agreement/ Operating Agreement

The limited partnership agreement, or in the case of an LLC structured fund, an operating agreement, is the legal governing document of the fund. It spells out the rules of fund and outlines the terms of the fund and the rights of everyone involved. These documents are legally binding agreements and should be prepared by experienced legal counsel. Both the partnership agreement and operating agreement are drafted in accordance to the specific state laws depending on the jurisdiction the fund was formed. Typical terms discussed in either document include:

- how profits are allocated and then distributed to all partners
- fees and expenses, including management & performance fees for the fund
- powers and activities of the general partner or LLC manager
- designation of power of attorney, allowing the fund manager to buy/sell fund securities, admit new investors, amend fund documents, and vote the fund's securities.
- withdrawal provisions, including lock-up periods, gates, and distribution dates.

Subscription Agreement

A subscription agreement is a legal document that provides investors with the legal process to purchase ownership in the fund. This is the contract between the fund and the investor which outlines the amount of the investment and the terms under which the investment is being made.

"Often subscription agreements require investors to attest that they meet certain eligibility standards, such as being an accredited investor as required by the SEC."

Although each fund has a variety of custom and detailed requirements for complying with regulatory filings; typical regulatory filings for new funds include:

- The SEC and state Form D filings, which are required whenever there is a U.S. investor;
- Investor advisor registration (depending on the type of investment, the amount of assets under management, and the state in which the fund managers are located).
- Registration with the Commodities Futures Trading Commission (CFTC) (This is applicable to certain hedge funds that invest in commodities, futures, swaps, currencies and similar instruments.)

REGULATORY FILINGS

Regulatory filings are the documents that need to be filed with the federal and state jurisdictions that are needed to satisfy certain securities laws and registration exemptions. These filings are potentially sent to the SEC, FINRA and state securities regulators.

A. Bradley Randall is the managing partner of Randall & Associates, a boutique law firm providing expertise focused on securities law and the investment industry. Call 480 330-5003 or email us to schedule a consultation to discuss your fund.
