Private Funds are excluded from the definition of an investment company and are, therefore, not registered under the US Investment Company Act of 1940 ("1940 Act" or "'40 Act"). Examples of private funds include hedge funds and private equity funds. Private funds may not make a public offering of their shares and, as a result, are limited to "accredited investors" in order to allow for a private offering complying with Regulation D.

- A section 3(c)(1) fund may not be beneficially owned by more than 100 shareholders.
- A section 3(c)(7) fund must be owned by "qualified purchasers." Section 3(c)(7) funds may have more than 100 investors, but typically limit the number of investors to 499, so as to avoid registration under the Securities Exchange Act of 1934 ("1934 Act").

**Investor Profile**

- Section 3(c)(1) funds and Section 3(c)(7) funds offer their interests in private offerings limited to "accredited investors" as defined by rule 501 under the Securities Act of 1933. Currently, an accredited investor must either (i) meet an income test ($200,000/year or $300,000/year with spouse), or (ii) meet a net worth test ($1 million individually or jointly with spouse). The SEC has proposed a new definition which could increase these requirements.
- Section 3(c)(7) funds may be purchased only by people who are considered "qualified purchasers," which generally includes a married couple or an individual with over $5 million in investments and owned by 2 or more related natural persons (a family company); a person (such as an institutional investor) who owns and invests (on a discretionary basis) at least $25 million in investments; or a trust not formed for the specific purpose of acquiring securities.
- 401(k) and other retirement and employee benefit plans can invest in the fund subject to Plan Asset Rules.

**Regulatory Reporting Requirements**

- Most private funds include a subscription package that includes:
  - Private placement memorandum
  - Copy of the organizational agreement (i.e. LP or LLC)
  - Subscription agreement.
- SEC-registered investment advisers with at least $150 million in private fund assets under management must periodically file Form PF with the SEC.
Distribution, Advertising and Promotion

- May not be advertised or broadly marketed, except under the exemption provided under Rule 506(c) of Reg D.
- Marketing materials used by registered investment advisers are governed by the requirements under the Investment Advisers Act of 1940 ("Advisers Act").
- Direct marketing to specific potential investors is permitted.
- When the fund has a broker-dealer as a private placement agent, marketing materials are subject to FINRA Conduct Rules.

Fund Launch Timeline and Organizer Requirements

- Launch typically takes 60 days, since there are no SEC filing requirements for private funds.

Fund Operational Organization Structure

- Section 3(c)(1) and Section 3(c)(7) funds generally vest extensive management authority in the general partner (LP model) or managing member (LLC model).
- Governance – There is typically no governing body similar to a board.
- Administrator – A third-party administrator generally oversees administration of the fund. While this function may be fulfilled by the fund's investment adviser, particularly post-Madoff, investors prefer independent administration.
- Custodian – Assets are generally held with a prime broker.

Initial and Ongoing Costs

- Costs are generally considered low compared to registered funds.

Fees and Fee Limitations

- A registered investment adviser may charge a performance-based fee if each investor in the fund is a "qualified client," as defined by the Advisers Act.

Taxation

- If formed as a limited partnership, limited liability company, or business trust under state law, then the fund typically can elect partnership status for federal tax purposes.