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Securities & Futures Regulation of Private Funds With Dual Elements Of Securities & Futures Privately Offered Funds Relying on Regulation D Rule 506

<u>Law and Issue</u>	<u>Securities Fund</u> Legal Requirements, Exemptions & Suggested Action	<u>Futures Fund</u> Legal Requirements, Exemptions & Suggested Action
<p>1933 Securities Act (Securities Registration or Exemption); Filing Requirement</p>	<p>Regulation D Rule 506 Exemption from registration. File Form D with Securities & Exchange Commission to claim Private Offering exemption. Offering must comply with the restriction on general solicitation, which forbids advertising, cold-calling, marketing on websites or by emails, to people you don't previously know. Unlimited accredited investors, 35 nonaccredited investors. Audited financials and full disclosure book required for nonaccredited investors.</p> <p>Futures Funds: 1933 Act applies, because fund is offering a pooled interest, which is deemed a security.</p>	
<p><u>Disclosure Documents:</u></p> <ul style="list-style-type: none"> • Offering Memo under the Securities 33 Act (Reg D) and Rule 10b-5, and • Disclosure Document for CFTC <p><i>Use Same Disclosure Document for Both</i></p>	<p>Offering Memo (Disclosure Document) Required, under 10b-5 (Antifraud) provisions of 1933 and 1934 Acts. Even private fund, exempt from SEC <i>registration</i>, is not exempt from <i>disclosure</i>. Therefore, fund must prepare a full Disclosure Document / Offering Memo, for investors, before they invest. Contents dictated by Reg D Rule 502. <i>Overlaps in many aspects with futures disclosure, therefore we use one book to cover both requirements.</i></p>	<p>CFTC's futures fund disclosure is similar to securities fund offering memo under '33 Act. But disclosure more complex for futures fund. Book subject to CFTC review, though often cursory review. File book with NFA & CFTC. Contents dictated by CFTC Rules 4.24 and 4.25. <i>Overlaps in many aspects with securities disclosure under Reg D; therefore we use one book to cover both requirements.</i></p>
<p>Financial Statement Requirements</p>	<p><i>Unaudited</i> Opening Balance Sheet. Unaudited Continuing Financials if all investors accredited. <i>Audited</i> Opening Balance Sheet Required for New Fund if nonaccredited investors. Audited Continuing Financials if nonaccredited investors.</p>	<p>Audited Financial Statements for Commodity Pool, unless exemptions apply. Performance Tables for CTAs.</p>

Blue Sky (State Securities Law) – State Registration of Fund

Form D Notice Filing Required + Other Documents + Filing Fees in Each State (Filing Fees Range From \$75 to \$985, average is \$200-\$300 per state. Legal fees \$500 per state.

No additional filings required for Futures; NASAA Commodity Pool Guidelines do not apply because fund is not publicly offered.

1940 Act (Investment Company Act – Registration of Exemption)

Exemptions:

- § 3(c)(1): Limit of 100 accredited investors, or
- §3(c)(7): Limit of 500 Qualified Purchasers.

QP is an Investor who owns \$5 million in investments or manages \$25 million in investments for self and others.

§3(b)(1) exemption from '40 Act for Commodity Pools; therefore no limit of 100 investors. Fund investments must be $\geq 40\%$ commodities or futures, in order to be exempt from '40 Act Registration. Exclude T-Bills from numerator and denominator to determine 40%.

However, Commodities Act compliance then required. Fund cannot avoid both Commodities Act and 1940 Act.

State Investment Company – Blue Sky

None

None

1934 Exchange Act – Broker-Dealer Registration

- Broker-Dealer Registration, or
- Issuer-Dealer Registration or Exemption

- Use a registered broker-dealer to market or sell Fund Interests (including your prime broker), or
- If not using a registered broker, rely on federal Rule 3(a)(4)-1 for an exemption from broker-dealer registration for officers of the issuer. Officer cannot be involved in offerings of any other issuers; receives no commissions, has not been involved in the last 12 months in any other offering, or
- Register the officer with the NASD, if person will be receiving compensation, commissions, finders fees, stock for bringing investors into the Fund. Series 7 Exam, U-4, Fingerprint cards. No bonding or net capital required.

State Broker-Dealer, or Issuer- Dealer, Registrations or Exemptions

- Use registered broker-dealer,
- Register any employee of the Issuer as an “agent of the Issuer” (Series 7 and 63 Exams required), U-4, some states require fingerprint cards, or
- Rely on state Issuer-Dealer Exemptions for Officers or Directors of the Issuer, who are not taking any fees for bringing in investors. A few states have such exemptions. States which do not have exemptions are CT, NH, VT, FL, among others. Illinois exemption at §2.

Commodities Exchange Act Applicability

Commodities Exchange Act applies as soon as only 1 futures contract will be traded for the fund (“commodity pool”). Even using futures to hedge in a securities fund, can trigger CEA applicability.

Commodities Exchange Act – NFA and CFTC Registration of People and Entities Offering the Fund

Not Applicable.

- Register the people with NFA / CFTC on Form 8-R as associated persons.
- Need Series 3 Exam
- Need Fingerprint cards.
- Register the Fund Manager (“sponsor”) with

NFA / CFTC as a Commodity Pool Operator¹
(CPO) and as a Commodity Trading Advisor
(CTA) on Form 7-R.

Commodities Exchange Act – NFA and CFTC Registration - or Exemption - of the Fund Itself

If <10% of the aggregate and additional margins are futures, then fund relieved of CFTC commodity pool record keeping (Rule 4.12).

Disclosure doc less complex, customer account opening documents not required if already done on the securities side for and customers.

Register Fund with CFTC & NFA as “Commodity Pool”² NFA review easier than CFTC.³

Exemptions from full CFTC registration, but CFTC & NFA Notice Filings still required before offers are made:

Rule 4.13: Start-Up fund (single fund only) which has total gross capital contributions of \leq \$200,000, and \leq 15 investors, and the fund is being charged only administrative expense, no management fees.

Rule 4.5: Funds Exempt from ‘33 Act under Reg D 506. Notice required.

Rule 4.7: QEP investor fund. Less than full disclosure requirements, shorter doc, fewer reporting requirements.

Investment Adviser’s Act of 1940: Applies to entities, or fund managers, who manage more than 1 fund, or who advise investors in which fund to invest.

Principals take Series 66 Exam (or has previous Series 65). Manager Files Form ADV with SEC on IARD electronic system, to register as investment adviser. SEC will audit Adviser once every 3 years, unless facts determine more frequent audit. Solid ADV disclosure, fund disclosure, trading compliance manual and AML compliance manual, will streamline the audit.

State Investment Adviser Registration

Simple electronic notifications (and small fees) required in states where Manager resides, and perhaps in states where fund clients reside (though not all states require notices where fund clients reside).

U.S. Patriot Act. Applies to funds accepting \$ from non-U.S. investors.

Fund manager must implement, and follow, Anti-Money Laundering Procedures, Compliance and Certifications by non-US investors, banks, brokers, others.

¹ Performance disclosure required for each and every trading advisor.

² Commodity pools may only trade securities that are approved by the CFTC.

³ Single Advisor versus multi-advisor fund affects disclosure document.