**Nancy Fallon-Houle, P.C.**

Attorney At Law

5449 bending oaks place

downers grove, Illinois 60515-4456

nfallon@nfhlaw.com 630-963-0439 x22 [www.nfhlaw.com](http://www.nfhlaw.com)

© Nancy Fallon-Houle, 1998-2014

Securities & Futures Regulation of Private Funds

With Dual Elements of Securities & Futures

Privately Offered Funds, Relying on Regulation D Rule 506 Securities Exemption

|  |  |  |
| --- | --- | --- |
| **Law and Issue** | **Securities Fund, Trading Fund, Futures Fund: Legal Requirements, Exemptions &****Suggested Action** | **Futures Fund****Legal Requirements in Addition to Column I; Exemptions & Suggested Action** |
| **1933 Securities Act (Securities Registration or Exemption); Filing Requirement** | **Regulation D Rule 506(b) Exemption from registration**. The 1933 Act exemptions from securities registration exempt either the “securities” themselves, or the “transactions” under which they are issued. Regulation D Rule 506(b) is a 1933 Act transaction exemption for private offerings. Although, it is a registration exemption, it still requires notice filings, and still requires the issuer to provide written disclosure to investors. File Form D with Securities & Exchange Commission online on EDGAR to claim Private Offering exemption. Offering must comply with the Rule 506(b) requirements, including the prohibition on general solicitation, which forbids advertising, cold-calling, mass emails to general lists, marketing from the manager’s website or other sites, social media plugs, seminar invitations or emails to people you don’t previously know.A 506(b) offering may accept unlimited number of accredited investors plus 35 nonaccredited investors. . Issuer must obtain written 3rd party confirmation of investor’s accredited status.If any nonaccredited investors: Audited financials, full disclosure book, and investor suitability questionnaire required for investment offered to nonaccredited investors. Lesser disclosure permitted for offering to all accrediteds. **Regulation D Rule 506(c ).** Unique conditions may allow limited public solicitation under Regulation D Rule 506(c), with strict requirements of accepting only accredited investors (with written 3rd party confirmation of accredited status.) |
| **Types of Funds Covered** | Securities Trading or Futures Trading Funds: The 1933 Act applies if the manager pools money of multiple investors into one entity, or into one trading account, for investing (= a pooled interest = a “fund” = a security). If investor money is kept in separate “managed accounts”, then it is not a “fund” or a “security”. However, the manager is then required to be registered as an Investment Adviser under the “Advisers Act” and parallel state acts.Futures Funds: 1933 Act applies, because fund is offering a pooled interest in a futures trading account. The pooled interest is deemed a security. |
| **Financial Statement Requirements** | *Unaudited* Opening Balance Sheet required for all investors. *Unaudited* Continuing Balance Sheet, Income Statement & Financials required if all investors accredited.*Audited* Opening Balance Sheet Required for new Fund if nonaccredited investors invest. Audited Continuing Financials if nonaccrediteds continue to invest. Audited financials and full disclosure book required for nonaccredited investors. For an offering to all accredited investors, audited financials are not required, but are currently “market” and therefore are typically provided, if not at opening, then after 1st year. | *Audited* Financial Statements required for Commodity Pool, unless exemptions apply.Performance Tables required for CTAs.Even if NFA Exemptions apply, the left column also applies if there are any non-accredited investors in the fund. It has become “market” to include audited financials into fund offering documents, especially futures funds, even if they are not required by the regulators. |
| **Disclosure Document: Offering Memo under the Securities 33 Act (Reg D) and Rule 10b-5 under the 1934 Act. Disclosure Document for CFTC.*****Use Same Disclosure Document for Both*** | Offering Memo (Disclosure Document) Required, under 10b-5 (Antifraud) provisions of 1933 and 1934 Acts. Even a private fund, exempt from SEC ***registration***, is not exempt from ***disclosure.*** Therefore, fund must prepare a full Disclosure Document / Offering Memo, for investors, before they invest. Contents dictated by Reg D Rule 502. | 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.*Overlaps in many aspects with securities disclosure under Reg D; therefore we use one offering book to cover both securities and futures requirements*.  |
| **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 $0 to $1,385, averaging $200-$300 per state. Legal fees $600 per state, except NY and CT are higher. | 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 99 accredited investors, or
* §3(c)(7): Limit of 499 Qualified Purchasers, or
* §3(b)(1) exemption for Commodity Pools

Qualified Purchaser 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 99 investors. Fund investments must be > 40 % commodities or futures, in order to be exempt from ’40 Act Registration. Exclude T-Bills from numerator and denominator to determine 40%.**However, if exempt from ’40 Act by virtue of being a “commodity pool”, then Commodities Act compliance is required. Fund cannot avoid both Commodities Act and 1940 Act if over 99 investors.** |
| **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 FINRA, if person will be receiving compensation, commissions, finders' fees, or equity / stock for bringing investors into the Fund. Series 7 Exam, U-4, Fingerprint cards. No bonding or net capital required.
* NFA CTA and CPO registrations also required for principals of futures fund manager to “sell” the fund. Similar to broker-dealer registrations, but simpler. See below “NFA and CFTC”.
 |
| **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.
* No additional requirements for futures funds.
 |
| **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.*** | Fund Managers with at least $150 million under management, must register with the SEC as an Investment Advisor. Fund Managers with less than $150 million, must register with their home state, if that state requires it. Principals take Series 66 Exam (or have previous Series 65). Manager files Form ADV with SEC on IARD electronic system, to register as investment adviser. SEC will audit Adviser approximately once every 3 years, unless facts determine more frequent audit. Solid & thorough disclosure on ADV Part I and Part II, as well as fund disclosure, trading compliance manual and AML compliance manual, will streamline the audit. |
| **State Investment Adviser Registration** | If Manager is SEC-Registered, then simple state electronic notifications (and small fees) required in states where Manager resides, and in states where fund clients reside (though not all states require notices where fund clients reside, and some de minimus exemptions may apply). If Manager is not SEC-Registered, then full state registration required, including paper and electronic components. |
| **Anti-Money Laundering: U.S. Patriot Act. *Applies to non-U.S. investors.*** | Fund manager must implement, and follow, Anti-Money Laundering Procedures, Compliance and Certifications by non-US investors, banks, brokers, others. |
| **Disaster Recovery**  | Disaster recovery plan for data, physical assets and the human beings, have become the standard of Practice in the Fund Management industry. |
|  |  |  |
| **NFA and CFTC - *Registration of* *People and Entities* Offering the Fund - Commodities Exchange Act Applicability** | Commodities Exchange Act applies even if 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. Even fund-of-funds that invest in funds that invest in commodities or futures are deemed to be commodity pools.* Register the people with NFA / CFTC on Form 8-R online as associated persons. Easy registration as long as background checks are clear.
* Need Fingerprint cards.
* Need Series 3 Exam. Series 30 for “Branch Manager” (or 32 if in Canada or UK) if there is an office separate from the main office (working from a home office = a “branch office”). Series 31 is the “Futures Managed Funds” Exam, not required, but demonstrates subject matter expertise to have the certification. No Futures Principals exam, unless your firm is a notice-registered BD firm.
* If firm is dually registered as a broker-dealer, NFA will accept the Series 9 or 10 (supervisory exams) or 24 (general securities principal exam) as the principals or branch manager’s exam.
* Register the Fund Manager (“sponsor”) with NFA / CFTC as a Commodity Pool Operator[[1]](#footnote-1) (CPO) and as a Commodity Trading Advisor (CTA) on Form 7-R.
 |
|  |  |  |
| **NFA and CFTC - *Registration - or Exemption – of the Fund Itself-* Commodities Exchange Act –** | Commodities Exchange Act applies even if 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. Even fund-of-funds that invest in funds that invest in commodities or futures are deemed to be commodity pools.Register Fund with CFTC & NFA as “Commodity Pool” [[2]](#footnote-2) NFA review easier than CFTC.[[3]](#footnote-3) Most private funds are exempt from CFTC registration, or exempt with a simple notice filing. But NFA filings still required for exempt funds, to register fund manager as CPO and CTA, plus fund exemption notice required. Register the Fund Manager (“sponsor”) with NFA as a Commodity Pool Operator[[4]](#footnote-4) (CPO) and as a Commodity Trading Advisor (CTA) on Form 7-R.Commonly used Exemptions from full CFTC registration listed below; but NFA Notice Filings still required before offers are made:Rule 4.13(a)(1) Closely Held Pool – Manager operates only 1 fund; Manager does not receive from the fund any management fees or compensation (only administrative expense reimbursement). No advertising.Rule 4.13(a)(2): Small Pool - Total gross capital contributions of < $400,000, and < 15 investors. Manager & its principals, and their contributions, excluded from the count toward 15 and $400K.Rule 4.13(a)(3) – De minimus – ’33 Act exempt, no advertising, all accredited investors, and, either:a.    The aggregate initial margin and premiums required to establish positions, determined when the most recent position was established, is < 5 % of the liquidation value of the pool’s portfolio, after taking into account unrealized profits and unrealized losses on positions it holds; orb.    The aggregate net notional value of positions, determined when the most recent position was established, is < 100 % of the liquidation value of the pool’s portfolio, after taking into account unrealized profits and unrealized losses on positions it holds.Rule 4.13(a)(4) – All QEP Investor Fund (a 3(c)(7) fund) – ’33 Act Exempt Fund, no advertising, all investors are QEPs. For a registered CPO, Rule 4.7 allows less than full disclosure requirements, shorter doc, fewer reporting requirements for the QEP Fund. Notice Filing Required.Rule 4.13(a)(3) Fund of Funds exemptionRule 4.12 – For Registered CPOs: Limits the amount of commodities held by the pool to <10% of the fund’s assets, and all futures trading must be only incidental to securities trading activity. File Notice and provide disclosure. 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. |
| **Dodd Frank** | Futures trading provisions. |
|  |  |

1. Performance disclosure required for each and every trading advisor. [↑](#footnote-ref-1)
2. Commodity pools may only trade securities that are approved by the CFTC. [↑](#footnote-ref-2)
3. Single Advisor versus multi-advisor fund affects disclosure document. [↑](#footnote-ref-3)
4. Performance disclosure required for each and every trading advisor. [↑](#footnote-ref-4)