U.S. Securities and Exchange Commission

Office of the Advocate for Small Business Capital Formation

How do private funds provide capital to early-stage companies?

A fund is an entity created to pool money from multiple investors—often referred to as limited partners. Each investor makes an investment in the fund by purchasing an interest in the fund entity, and the adviser uses that money to make investments on behalf of the fund. Traditional venture funds typically invest in businesses in exchange for equity and some firms specialize in particular industries or in companies at a certain stage (for example, early, mature, or later stage).

What laws apply to different aspects of a private fund's operations?

The Fund

INVESTMENT COMPANY ACT OF 1940

- Private funds are not required to be registered or regulated as investment companies under the federal securities laws. A private fund cannot publicly offer its securities.
- Private funds are structured to qualify for one of the following exclusions from the definition of investment company:

Traditional 3(c)(1) Fund	3(c)(7) Fund	3(c)(1) Qualifying Venture Capital Fund
no more than 100 benefical owners	*limited to qualified purchasers*	*no more than $10M from no more than 250 benefical owners*

The Advisor

INVESTMENT COMPANY ACT OF 1940

- A private fund adviser generally has broad discretion to make investment decisions on behalf of the fund, generally making all investment decisions in accordance with the fund's investment strategy.
- Private fund advisers are generally investment advisers that are required to register with the SEC or applicable state securities regulators as a registered investment adviser, unless they are exempt from applicable registration requirements (for example, as an exempt reporting adviser).
- An adviser's size and investment activities will generally determine applicable registration requirements.

The Capital Raise

SECURITIES ACT OF 1933

- Private funds raise capital from investors through exempt offerings, which means the offering must fall within an exemption from registration under the Securities Act of 1933.
- Rule 506(b) and Rule 506(c) of Regulation D are two common offering types. The offering will be disqualified from relying on either exemption if the fund or certain other persons (including the general partner, certain officers and directors, or any promoter) has a relevant criminal conviction, regulatory or court order or other disqualifying event (a "bad actor").
- Among other criteria outlined in Regulation D, the biggest difference between the exemptions is how the fund connects with their investors:

Rule 506(b)	Rule 506(c)
Rule 506(b) generally allows entities to raise capital from investors but prohibits the use of general solicitation	Rule 506(c) generally allows entities to raise capital by broadly soliciting investors

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