



# What do I need to know before starting a private fund?

## What is a private fund?

A [private fund](#) is an entity created to pool money from multiple investors that is not required to be registered or regulated as an [investment company](#) under the [Investment Company Act](#). Private funds can differ, however, in how they pool money and how they deploy that money. Let's consider a few general approaches.

## How do private funds pool money from investors and what are some common investment approaches?

### When do investors provide capital?



- [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:

#### Venture Capital Funds

[Venture capital funds](#) typically

- accept capital commitments from investors
- “call down” capital from investors as needed over time for the fund to make investments

#### Private Equity Funds

[Private equity funds](#) typically

- accept capital commitments from investors
- “call down” capital from investors as needed over time for the fund to make investments

#### Hedge Funds

[Hedge funds](#) typically

- require capital contributions from investors up front to enable the fund to deploy that capital quickly

### In what types of companies do private funds invest?



#### Venture Capital Funds

Venture capital funds typically

- invest in illiquid, private assets—such as startups and other early-stage private companies
- take minority interests in their [portfolio companies](#)
- limit investors' rights to withdraw their investments from the fund

#### Private Equity Funds

Private equity funds typically

- invest in illiquid, private assets—including growing and later-stage private companies—or in public companies that they intend to take private
- take controlling interests in their portfolio companies and often use leverage, or borrowing, to do so
- limit investors' rights to withdraw their investments from the fund

#### Hedge Funds

Hedge funds typically

- invest in liquid assets—such as publicly-traded [securities](#)—and often use investment practices such as short selling and leverage
- provide their investors flexible withdrawal rights from the fund

### How do private funds interact with their portfolio companies?



#### Venture Capital Funds

Venture capital funds typically

- serve as advisers to their portfolio companies, providing, for example, operational and/or strategic advice and connections, and may serve on a portfolio company's board

#### Private Equity Funds

Private equity funds typically

- are engaged in the management of their portfolio companies, particularly when they acquire a controlling interest in a company

#### Hedge Funds

Hedge funds typically

- do not directly engage in the management of the specific assets in which they invest (with the exception of certain specialized strategies such as shareholder activism)

In addition to these examples, there are other types of private funds and hybrid investment approaches. A new fund manager should consult with legal counsel as to the type of fund that makes the most sense for them, keeping in mind that whatever approach is selected will have further implications than are discussed here, including the determination of [performance fees](#) and the timing of distributions to investors.

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# What do I need to know before starting a private fund? *(continued)*

## What else do I need to consider as I start my private fund?

The following considerations may help guide you.



### Fund Considerations

**Legal Structure.** A private fund and any management entities require legal formation. For example, some private funds are structured as limited partnerships, in which case, the partnership will have a [general partner](#) and investors will participate as [limited partners](#). Other legal structures include limited liability companies and corporations.

**Documentation.** Private funds are structured to reflect an arrangement between the fund's manager(s) and its investors. Fund documents govern the relationships among those parties. For example, if you structure your private fund as a limited partnership, a limited partnership agreement, or LPA, will document the fund's key legal terms and mechanics. This may include how the general partner may call for capital commitments, how profits are split between the general partner and the limited partners, any [management fees](#), and the extent to which limited partners may withdraw from the fund.



### Investment Adviser Considerations

**Firm Organization.** A private fund is more than just the fund itself. The fund may have a separate [investment adviser](#) that provides investment advice. The investment adviser and any other "management" entities are each separate legal entities that will need to be formed and will have their own underlying partners or members.

One or more of the management entities will be an [investment adviser](#). An investment adviser is required to register with either the [SEC](#) or its applicable [state securities regulator](#) as a [registered investment adviser](#) unless it is exempt or prohibited from applicable registration requirements. For example, [exempt reporting advisers](#) are exempt from registering with the SEC but are still subject to certain reporting requirements.

**Documentation.** Documentation often includes an investment management agreement governing the responsibilities of the investment adviser. If the investment adviser comprises more than one person, consider documenting the arrangements between the applicable parties, such as how to split management responsibilities and compensation between those persons and/or any employees.



### Capital Raise Considerations

**Capital Raising.** How—and from whom—do new fund managers raise capital? Consider your investment focus: what types of assets or companies do you plan to invest in? Do you have a geographic focus? Do you or any co-founders have a personal track record that you can point to?

As you seek to raise capital, keep in mind that your fundraiser will be subject to federal and [state securities laws](#). Private funds raise capital from investors through [exempt offerings](#), which means any offering must fall within an [exemption](#) from registration under the [Securities Act](#); Rule 506(b) and Rule 506(c) of [Regulation D](#) are two common offering types.

**Documentation.** Documentation for your capital raise may include, among other things:

- an offering document—frequently called a private placement memorandum—that acts as a detailed disclosure document for potential investors; and
- a subscription agreement through which investors contract to invest in the private fund.

These are only a handful of items that you may want to consider as you establish your private fund. The right advisers, including legal counsel, can help guide you through your options and advise you on the best course of action for your private fund.

Have suggestions on additional educational resources? Email [smallbusiness@sec.gov](mailto:smallbusiness@sec.gov).

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