KLEINBERG KAPLAN

Legal Update

Impact of the JOBS Act on Hedge Funds and Private Equity Funds

May 2012

On April 5, 2012, President Obama signed into law the Jumpstart Our Business Startups Act (the "JOBS Act") which amends certain provisions of the federal securities laws. Of particular significance to hedge funds and private equity funds are:

- the elimination of the ban on general solicitation and general advertising under Regulation D of the Securities Act of 1933, as amended (the "Securities Act"), in connection with sales to accredited investors, and
- the increase of the shareholder of record threshold for becoming a reporting company under the Securities Exchange Act of 1934, as amended (the "Exchange Act") from 500 persons to either (i) 2,000 persons or (ii) 500 persons who are not accredited investors.

Eliminating the Ban on General Solicitation and General Advertising

The JOBS Act directs the Securities and Exchange Commission (the "SEC") to amend Rule 506 of Regulation D ("Rule 506") to provide that the prohibition against general solicitation or general advertising shall not apply to offers and sales of securities made pursuant to Rule 506, so long as the purchasers of such securities are all accredited investors. Since many hedge funds and private equity funds accept only accredited investors, this amendment would permit such funds to engage in general solicitation or general advertising in connection with a Rule 506 offering. The SEC must amend Rule 506 no later than 90 days after the enactment of the JOBS Act. The prohibition against general solicitation and general advertising remains in effect until such amendments are adopted by the SEC. The actual terms of the amended Rule 506 will need to be reviewed when they are finalized to determine if there are any other limitations and/or qualifications included in the amendment which may impede the use of general solicitation or general advertising by hedge funds or private equity funds.

Hedge funds and private equity funds that rely on Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act of 1940, as amended (the "Company Act") are prohibited from making a "public offering" of their securities. The JOBS Act specifically provides that a Rule 506 offering shall not be deemed a public offering under federal securities laws as a result of general solicitation or general advertising. Therefore, funds that engage in general solicitation or general

advertising pursuant to the amended Rule 506 should be able to continue relying on Section 3(c)(1) or Section 3(c)(7) of the Company Act.

It is important to note that hedge funds and private equity funds may be subject to restrictions on offers and sales to the public other than pursuant to the federal securities laws. For example, funds whose managers are exempt from registering as commodity pool operators ("CPOs") with the Commodity Futures Trading Commission ("CFTC") pursuant to CFTC Regulation 4.13(a)(3) are prohibited from marketing to the public in the United States. In addition, funds whose managers are registered as CPOs, and who rely on CFTC Regulation 4.7 for relief from certain CFTC disclosure and reporting requirements, may be limited in their ability to engage in a general solicitation or general advertising of their interests. Funds that want to engage in general solicitation or general advertising while also complying with other laws and regulations such as CFTC Regulation 4.7 or 4.13(a)(3) should consult with legal counsel prior to engaging in such actions.

In addition, a hedge fund or private equity fund that wants to engage in a general solicitation or general advertising in connection a Rule 506 offering should consider whether that offering may be "integrated" with prior or future offerings that included or will include sales to non-accredited investors. Any such integration may jeopardize the fund's reliance on amended Rule 506.

Increasing the 500-Record Shareholder Threshold

As the hedge fund and private equity fund industry has grown, a number of hedge funds and private equity funds have had to address the issue of becoming a "reporting company" under the Exchange Act. Under Section 12(g) of the Exchange Act, an issuer is required to register its securities under the Exchange Act if it has more than $10 million in total assets and a class of equity securities held of record by 500 or more persons. Registration under the Exchange Act requires an issuer to file annual and quarterly reports with the SEC and to comply with other burdensome provisions of the federal securities laws. As a result, hedge funds and private equity funds have generally imposed a limit of 499 investors per each class of shares being offered. Effective as of April 5, 2012, the JOBS Act increases the shareholder of record threshold from 500 persons to either (i) 2,000 persons or (ii) 500 persons who are not accredited investors. In addition, the JOBS Act provides that employees who receive securities pursuant to an employee compensation plan in transactions exempted from Securities Act registration are not deemed to be shareholders of record and directs the SEC to amend its regulations accordingly.

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