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Question Presented

My client will form a fund (a limited liability company) and raise \$3M of capital from accredited investors to trade in the prediction markets. Which laws apply? What registrations are required, if any?

Response:

Your client's fund, structured as a limited liability company (LLC) and raising \$3 million from accredited investors to trade in prediction markets, will need to comply with several laws and regulations, including the Securities Act of 1933, the Investment Company Act of 1940 (ICA), and potentially state securities laws (blue sky laws). Below is an overview of the applicable laws and registration requirements:

1. Securities Act of 1933 and Regulation D:

The fund's offering of securities will likely qualify as a private placement under Regulation D, specifically under Rule 506(b) or Rule 506(c).

- **Rule 506(b)** allows the fund to raise an unlimited amount of capital from an unlimited number of accredited investors and up to 35 non-accredited but sophisticated investors, provided there is no general solicitation or advertising ([Practice notes, Private Equity Fund Formation](#))[1], ([Practice notes, Securities Laws in Venture Finance](#))[2].
- **Rule 506(c)** permits general solicitation and advertising but requires that all purchasers be accredited investors and that the fund take reasonable steps to verify their accredited status ([Practice notes, Private Equity Fund Formation](#))[1], ([Practice notes, Securities Laws in Venture Finance](#))[2], ([Practice notes, Road Map for Undertaking a Private Offering](#))[3].
- The fund must file a Form D with the SEC within 15 days of the first sale of securities ([Practice notes, Private Equity Fund Formation](#))[1], ([Practice notes, Securities Laws in Venture Finance](#))[2].

2. Investment Company Act of 1940 (ICA):

The fund must avoid being classified as an investment company under the ICA, which would require burdensome registration and compliance obligations. To do so, the fund can rely on one of two key exemptions:

- **Section 3(c)(1)**: The fund must not make a public offering and must have no more than 100 beneficial owners ([Practice notes, Private Equity Fund Formation](#))[1].
- **Section 3(c)(7)**: The fund must not make a public offering and must be owned exclusively by qualified purchasers (generally high-net-worth

individuals or entities meeting specific thresholds) ([Practice notes, Private Equity Fund Formation](#))[1].

3. **Accredited Investor Verification:**

The fund must ensure that all investors meet the definition of accredited investors under Rule 501(a) of Regulation D. Accredited investors include individuals with a net worth exceeding \$1 million (excluding primary residence) or annual income exceeding \$200,000 (\$300,000 with a spouse), among other categories ([Practice notes, Road Map for Undertaking a Private Offering](#))[3], ([Practice notes, Section 4\(a\)\(2\) and Regulation D Private Placements](#))[4].

4. **State Securities Laws (Blue Sky Laws):**

The fund must comply with state securities laws, which may require additional filings or notices in the states where investors are located ([Practice notes, Private Equity Fund Formation](#))[1].

5. **Broker-Dealer Registration:**

If anyone is paid a commission for raising capital for the fund, they may need to register as a broker-dealer with the SEC. Failure to do so could result in sanctions and investor rescission rights ([Practice notes, Private Equity Fund Formation](#))[1], ([Practice notes, Broker-Dealer Issues for Private Funds](#))[5].

By adhering to these requirements, your client can ensure compliance with applicable securities laws while raising capital for the fund.

The above response is AI-generated and may contain errors. It should be verified for accuracy.

Sources (5)

[1. Private Equity Fund Formation](#) (Practice notes • Maintained • National/Federal)

“... Certain US Regulatory Matters - Securities Act - The JOBS Act and Regulation D. To implement Section 201(a)(1) of the JOBS Act, the SEC created a new subsection (c) of Rule 506 of Regulation which permits Rule 506 offerings using general solicitation and general advertising if three conditions are met: Each investor in the offering is an accredited investor. , The fund takes reasonable steps to verify that each investor is an accredited investor. , All other terms and conditions of Rule 501, 502(a), and 502(d) under Regulation D are satisfied. The existing private placement safe harbors of Rule ...”

“... Certain US Regulatory Matters - Investment Company Act. The ICA regulates mutual funds and other companies that engage primarily in investing, reinvesting, and trading in securities and offer their own securities to the investing public. Companies subject to the ICA are required to either register with the SEC as an investment company or qualify for an exemption from registration. Sponsors of private equity funds formed in the US or with US investors generally try to qualify for an exemption from registration because registration would make it impracticable for a sponsor to properly administer ...”

“... The Section 3(c)(1) and 3(c)(7) exemptions are complex, including a number of rules requiring the fund to look through certain investors to determine their ultimate beneficial owners. For example: Each exemption requires a fund to disregard and look through to the beneficial owners of any entity formed for the purpose of investing in the fund. Section 3(c)(1) requires a fund to look through any investor that: is itself an investment company (or would be an investment company but for the Section 3(c)(1) and 3(c)(7) exclusions); and owns more than 10% of the voting securities of the fund. Section ...”

“... In addition to relying on the Section 4(a)(2) private placement exemption, a sponsor may try to qualify for one of the private placement safe harbors provided by Regulation D (see Practice Note, Section 4(a)(2) and Regulation D Private Placements: Regulation D Requirements). Regulation D contains multiple regulatory safe harbors from the Securities Act registration requirements, each with its own offeree qualifications and limitations. An offering under Rule 506(b) of Regulation D is generally subject to the following requirements: No general advertising or solicitation., Offering materials must ...”

“... (See *Halliburton Co. v. Erica P. John Fund, Inc.*, 573 U.S. 258, 267 (2014) A fund investor may be unable to prove that a misrepresentation or omission occurred or that it reasonably relied on a misrepresentation or omission, however, if the fund’s PPM fully and adequately disclosed the potential risks that supposedly led to the investor’s loss (see Private Placement Memorandum). The Exchange Act also requires that anyone engaged in the business of effecting transactions in securities for an issuer must be registered as a broker with the SEC (for an overview of broker-dealer registration requirements ...”

“... General Fund Structure - Investment Fund. Private equity funds are structured as closed-end investment vehicles. A fund’s governing documents generally permit the fund to raise capital commitments during a limited fundraising period (12 to 18 months is common, typically subject to extension), after which the fund may not accept additional investor commitments. During the capital raising period, the sponsor seeks investors to subscribe for capital commitments to the fund. The commitment is not usually funded all at once, but in separate capital contributions called by the sponsor on an as-needed ...”

“... Fundraising and Fund Closing - Fund Marketing. Fund capital raisings in the US are nearly always made as private placements of securities (in accordance with exemptions from the registration requirements of the federal securities laws) to: Institutions, including: government and corporate pension plans; financial institutions; university endowments; foundations; sovereign wealth funds; funds of funds; insurance companies; and family offices. , and High-net-worth individuals (see Securities Act). Private placements are generally made through a series of one-on-one presentations to investors ...”

2. Securities Laws in Venture Finance (Practice notes • Maintained • National/Federal)

“... Section 4(a)(2) - Rule 506(b). One of the most popular safe harbor exemptions from registration is Rule 506(b) of Regulation D. Similar to Section 4(a)(2), Rule 506(b) does not limit the amount of capital an issuer can raise in a private placement. It permits an unlimited number of accredited investors and up to 35 non-accredited investors that are

sophisticated investors to participate in the offering. The absence of a cap and generous accredited investor base makes Rule 506(b) an important safe harbor. General solicitation is not allowed under Rule 506(b). However, there are rules governing certain ...”

“... Section 4(a)(2) - Rule 506(c). Rule 506(c) permits issuers to broadly solicit and generally advertise an offering (general solicitation), provided that: All purchasers in the offering are accredited investors (see Accredited Investors)., The issuer takes reasonable steps to verify purchasers’ accredited investor status., and Certain other conditions in Regulation D are satisfied. Rule 506(c) permits an unlimited number of accredited investors in the offering and allows companies to raise unlimited capital, as long as the issuer satisfies all of the conditions of the rule. However, Rule 506(c) has ...”

3. Road Map for Undertaking a Private Offering (Practice notes • Maintained • National/Federal)

“... Generally, an accredited investor is any one of the following: A trust with assets of at least \$5,000,000, not formed to acquire the securities offered, and whose purchases are directed by a sophisticated person. A natural person who holds in good standing one or more professional certifications or designations or credentials from an accredited educational institution that the SEC has designated as qualifying an individual for accredited investor status. On August 26, 2020, the SEC issued an order designating the following certifications, when held in good standing, as qualifying natural persons ...”

“... Choosing a Type of Offering - Regulation D: The Private Offering Exemption - Rule 506(c). Rule 506(c) is similar to Rule 506(b) in that it contains no limit on the amount of capital that can be raised in an offering or the number of accredited investors that can purchase securities. However, unlike Rule 506(b), Rule 506(c) permits issuers to communicate with investors and potential investors through general advertising and general solicitation, as long as: The issuer takes”reasonable steps” to verify that each purchaser is an accredited investor., At the time of the sale of the securities, all ...”

4. Section 4(a)(2) and Regulation D Private Placements (Practice notes • Maintained • National/Federal)

“... Rule 501(a) of Regulation D provides the following categories of accredited investors, including investors that the issuer reasonably believes qualify as: Institutional investors, including: US banks (Section 3(a)(2), Securities Act); US branches or agencies of foreign banks (from SEC guidance); savings and loan associations (Section 3(a)(5)(A), Securities Act); registered broker-dealers; registered investment advisers; investment advisers exempt from registration under Section 203(l) or (m) of the Investment Advisers Act of 1940 (Advisers Act); registered investment companies; business development ...”

5. Broker-Dealer Issues for Private Funds (Practice notes • Maintained • National/Federal)

“... Private Funds. Private funds generally are collective investment vehicles: That are exempt or excluded from registration as investment companies under the Investment Company Act of 1940 (Investment Company Act)., and With ownership interests sold through private placements exempt from registration under the Securities Act. These exemptions or exclusions are based on limiting the offering of interests in private funds to

certain categories of sophisticated investors including: Accredited investors., and Qualified purchasers. Private funds are typically structured as either limited partnerships or ...”