KEY RULES AND REGULATIONS FOR COUNSEL ADVISING INVESTMENT FUNDS AND ADVISERS

FOUNDATIONS OF FUND COUNSEL SERIES: PART 1

DBA Securities Section
October Meeting

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Shareholder
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October 27, 2025

Overview

- Untangling the Private Equity Ecosystem
- The Asset Class and its Stakeholders
- Regulation of Investment Advisers and Private Funds
- Lifecycle and Needs
- Common Structures and Issues



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THE PRIVATE EQUITY ECOSYSTEM

Defining Private Equity

A. AN ASSET CLASS

B. AN INVESTMENT TYPE

C. AN INVESTMENT STRUCTURE

D. A STYLE OF INVESTING

E. ALL OF THE ABOVE



Defining Private Equity

Asset Class. Private equity is an asset class that involves investing in companies that do not have publicly listed securities. It encompasses a wide range of investment opportunities, from early-stage startups in need of seed capital to well-established companies generating significant cash flow.

Key Characteristic. Closed-end, private equity investments are typically characterized by longer holding periods and illiquidity, requiring investors to commit their capital for extended periods.

Risks. While private equity offers potential higher returns, it also entails risks such as limited liquidity and the absence of oversight from regulatory bodies from governmental agencies and other regulators such as the SEC and FINRA in the U.S.

Multiple Access Points. Investing in private equity may directly or indirectly involve investments in LBOs, direct equity, debt instruments, co-investments, feeder investments, fund-of-fund investments, participations in secondary market trading of private fund interests, VC-style investments, PIPEs, and more.

What is an Alternative Investment?

An alternative investment is a financial asset that does not fall into one of the conventional investment categories. (Investopedia)

Alternative investments are asset classes that are not stocks, bonds, or cash. These kind of investments differ from traditional investment types because they are not easily sold or converted into cash. (HBS)

- Alternatives cover a wide range of investments with unique characteristics.
- Many alternatives are becoming accessible to retail, or individual, investors – making knowing about them increasingly important for all types of investors and industry professionals.
- The types of alternative investments can vary wildly in their accessibility and structure, but share the following characteristics:
  - they are more lightly regulated by the SEC;
  - they are illiquid, meaning they can't be sold easily or otherwise converted to cash; and
  - they have a low correlation to standard asset classes, meaning they don't necessarily move in the same direction as other assets when market conditions change.

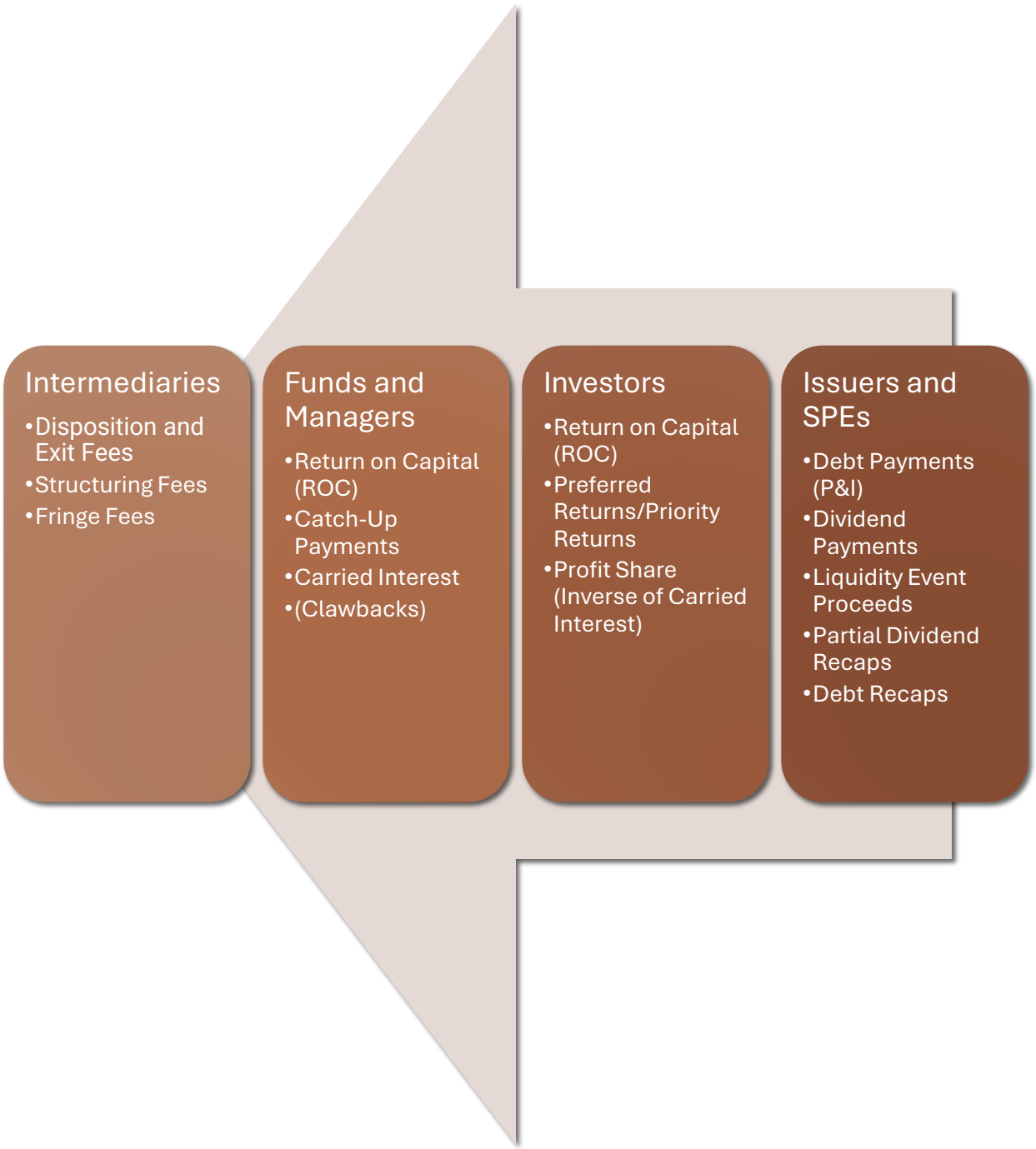
The Inflow Ecosystem: Investors to Investments



The Inflow Ecosystem: Capital Flows and Fees



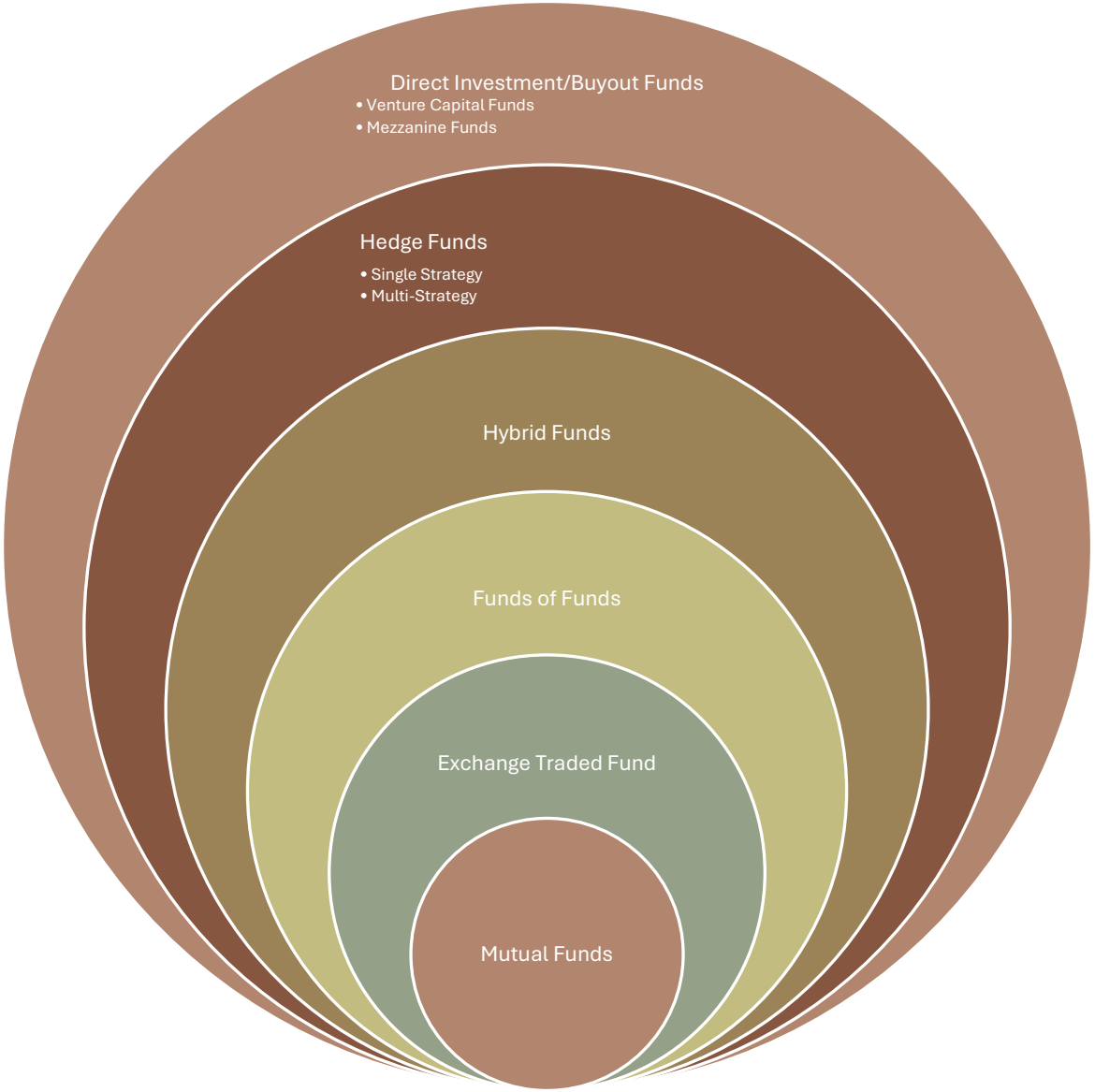
The Inflow Ecosystem: Capital Flows and Fees



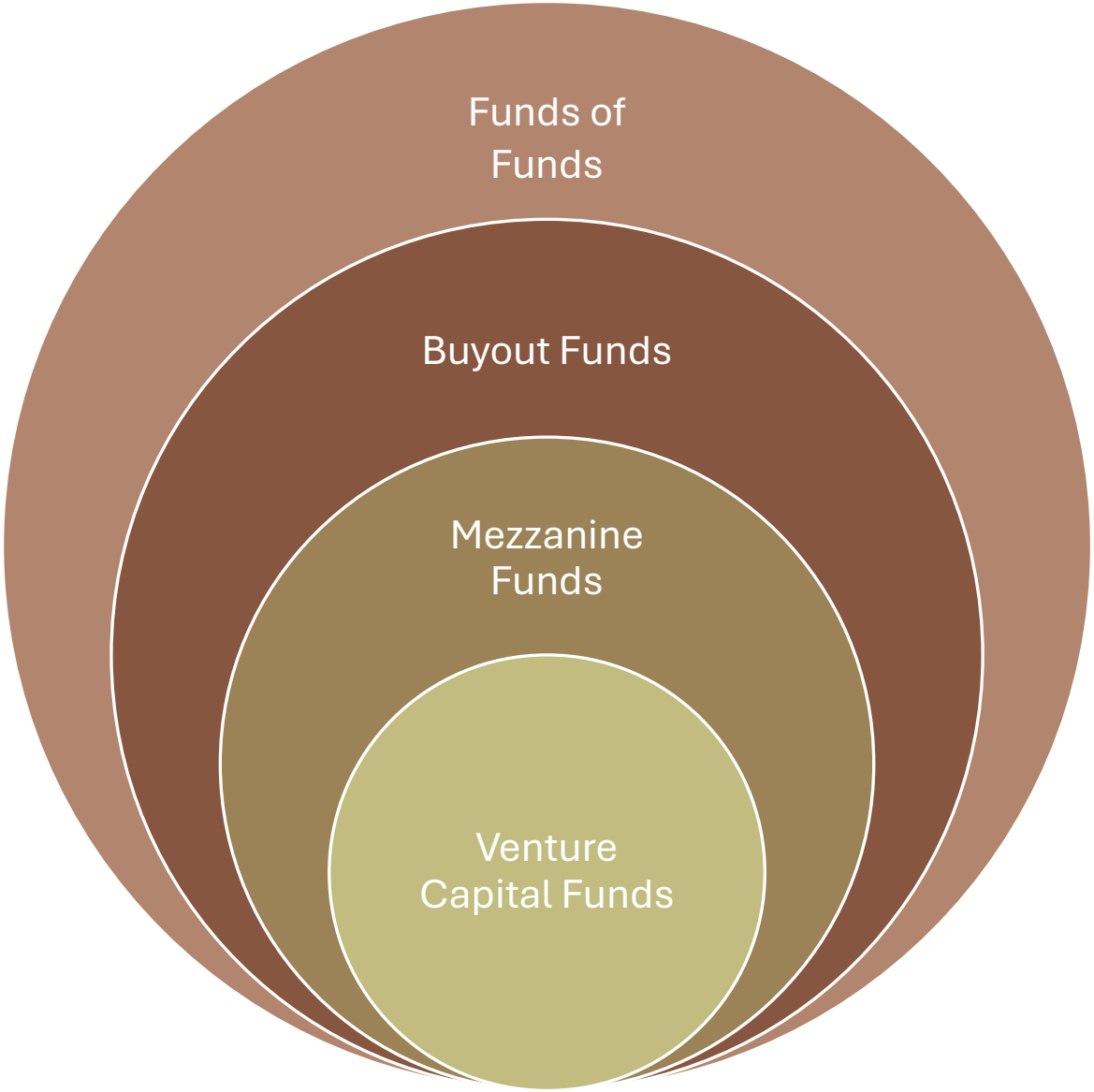
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TYPES OF FUNDS

Universal Fund Types



Focus on Private Equity



Traditional Funds: Buyout Funds

Key Feature . A direct investment or buyout fund invests “directly” in a company in a privately-negotiated transaction, whether through the acquisition of equity, extension of credit or a combination of the two.

Not a Hedge Fund. A hedge fund will generally invest in marketable securities, commodities, currencies or other highly liquid asset classes.

Why it Matters. The means by which capital is aggregated, deployed and harvested, as well as the valuation of assets and return metrics, for a fund will diverge materials as between different funds types.

Traditional Funds: Venture Capital

Key Feature . A direct investment fund that invests in the equity of startup firms and small businesses with exceptional potential for growth and loss.

Horizons and Risks. Venture capitalists often do not view their individual investments as high-risk, instead working a “portfolio strategy” with what are highly-illiquid assets. They certainly realize that “perceived risk” is quite high, and are therefore able to take advantage of the shortage of capital to obtain positions in their portfolio companies that are disproportionate to their “actual” risk.

Expectations. VC investments in an enterprise will range from the small in amount to surprisingly large amounts, with investor expectations reaching 20% to 50% IRRs and 3x or greater multiples.

Types of Funds: Mezzanine Funds

Key Feature . Mezzanine capital (or mezzanine debt) is a broad term used to refer to debt that generally is (1) unsecured, (2) high-yield, (3) subordinated to senior debt, and (4) supported by an equity kicker such as a warrant.

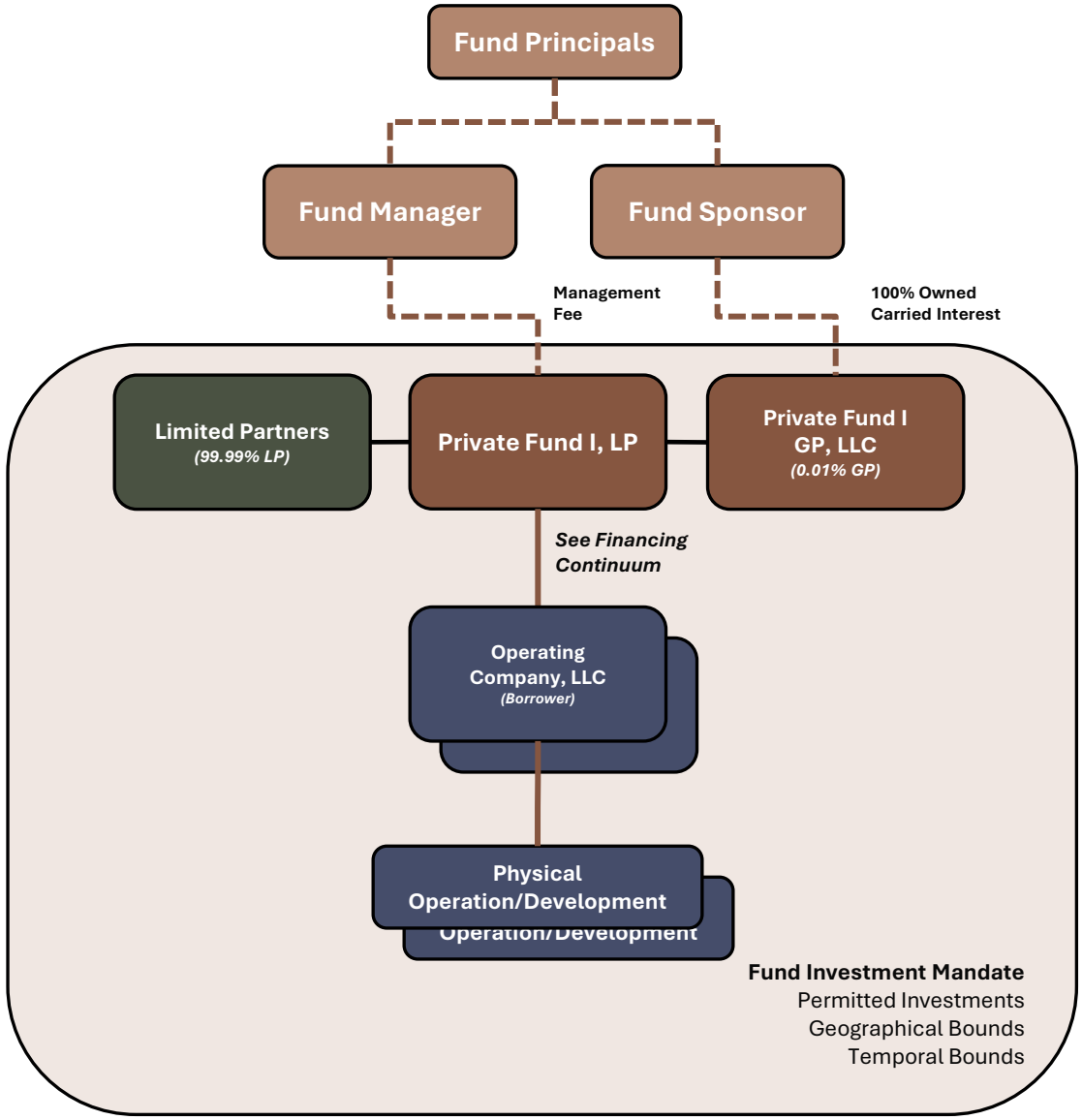
Why Mezzanine. Mezzanine capital is a more expensive form of financing, which is right-sized by the market based on the subordinate position of the mezzanine lender. As such, mezzanine interest rates are generally in the 10%-14% range, in addition to the equity stake that the mezzanine lender will take in the company.

How to. A big topic for later. Mezzanine investments can range from $1 million to $100 million or more, with investors targeting an aggregate 20% rate of return on the investment.

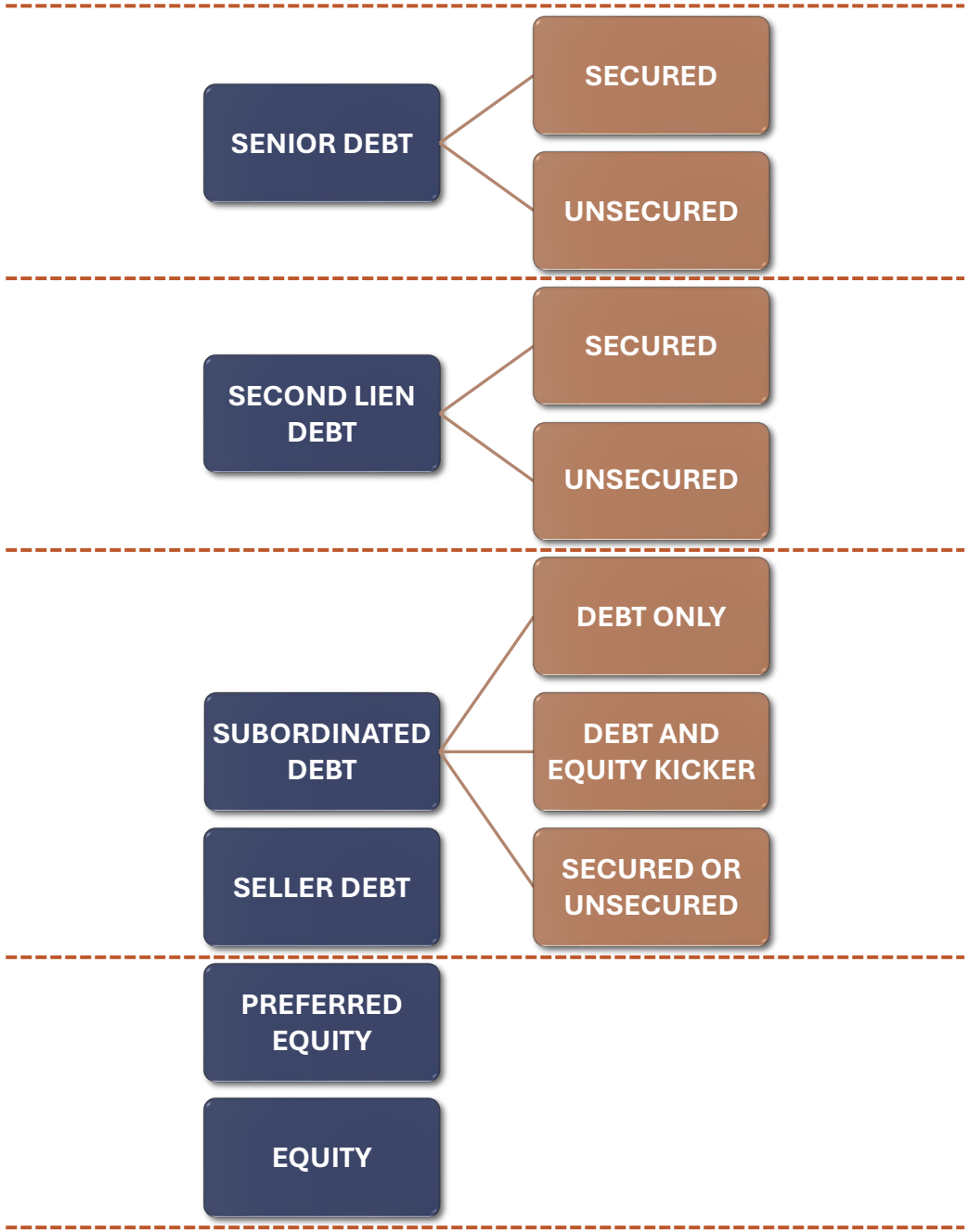
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STRUCTURE AND INVESTMENTS

The Traditional Private Equity Fund Structure



The Private Equity Financing Continuum



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WHERE THE LAWYERS FIT

What Tools do You Need?

Hint: You already have what you need…

- Do you need a degree in finance?
- Should you have interned with a company or bank?
- Will what you learned in law school make or break your career as a deal lawyer?

Good News: The Bottom Line

- You already bring most of the tools to your desk, or have them at your desk
- Being committed and relentless about using them and refining them is what separates the good from the great, the average from the good, and the…you get the idea

Types of Deals

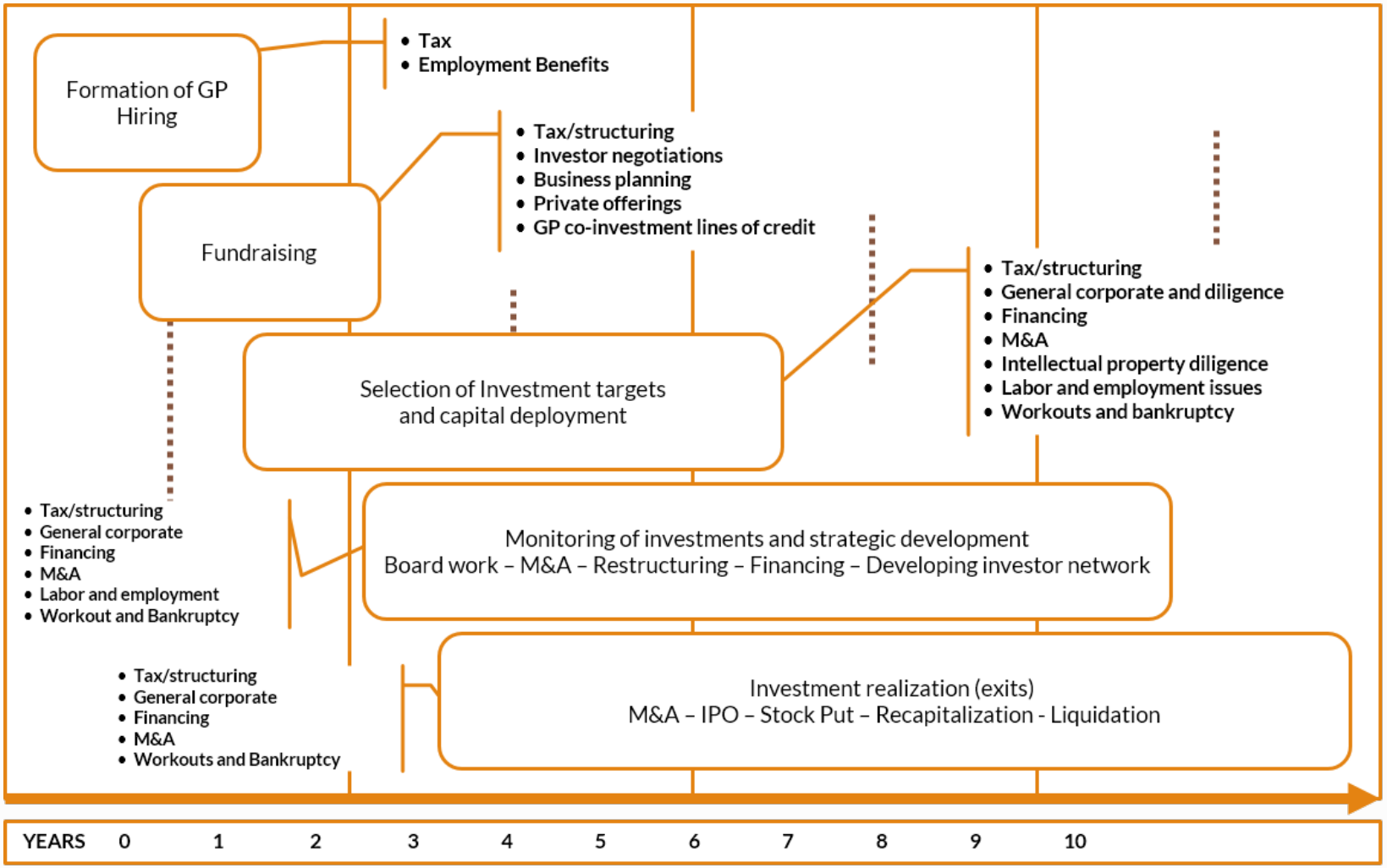
Categorizing assignments quickly

Lending and Debt Financing
Senior Credit (Secured and Unsecured)
Syndicated Senior Credit (Secured and Unsecured)
Second-Lien Credit (Secured and Unsecured)
Subordinated Debt (Secured and Unsecured)
Syndicated Subordinated Debt (Secured and Unsecured)
Restructurings and Workouts
Bankruptcy and Foreclosures
Debt Trades and Participations
Securities Offerings and Investing
Investment Fund Formation
Investment Fund Deployment
Investment Fund Harvesting
General Partner Advisory
SBIC Funds
EB-5 Funds
Corporate Preferred Stock Offerings
Corporate Convertible Debt Offerings
Venture Capital
ESG and Social Impact Investing
Hedge Funds
Broker/Dealer and RIA Advisory (FINRA/SEC)

Types of Deals

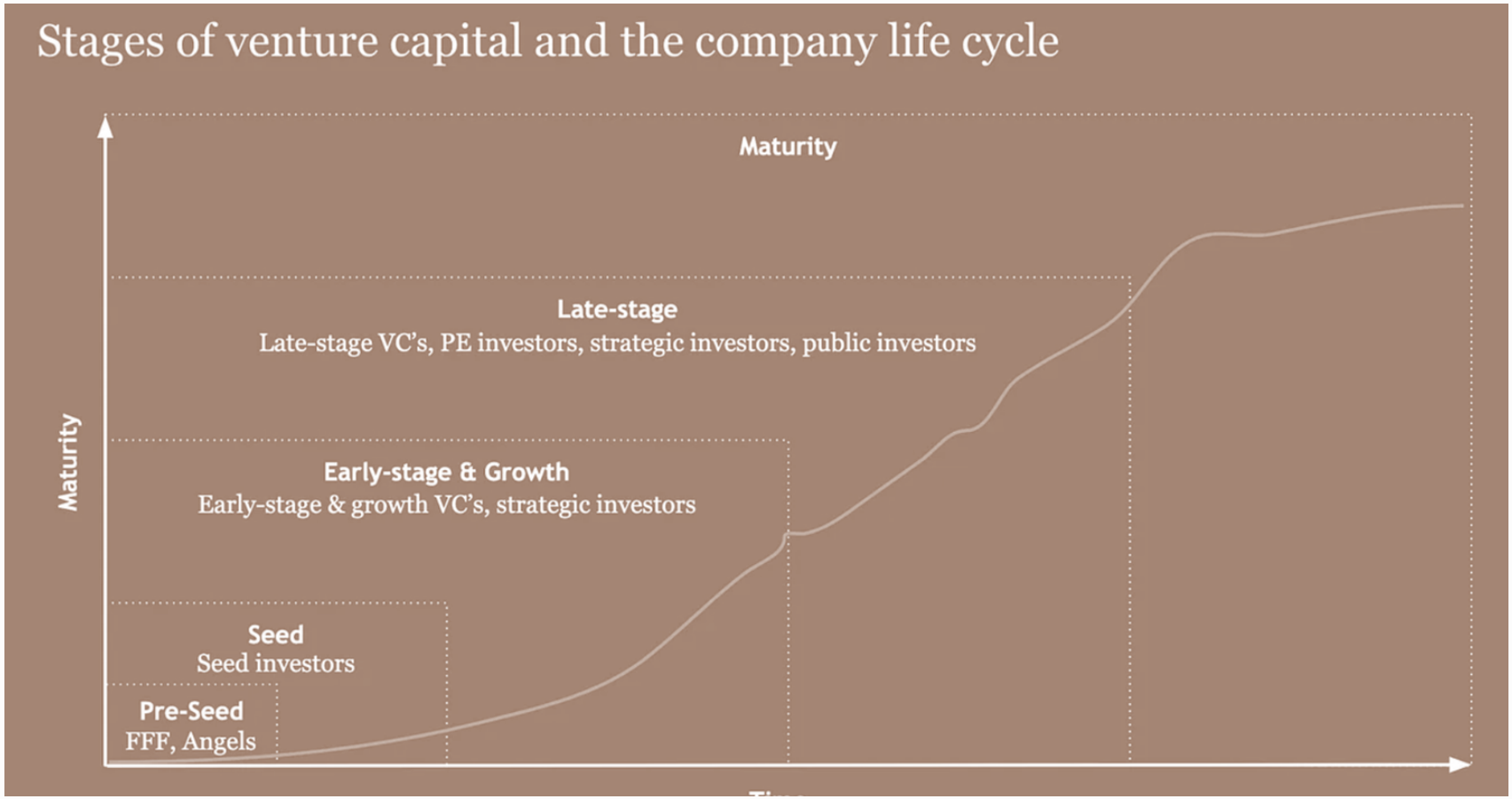
Categorizing assignments quickly

Mergers and Acquisitions
Asset and Stock Purchase Transactions
Asset and Stock Purchase Financing
SPV Formation and Management
Contract Negotiating and Drafting
General Commercial Contracts
Equipment Leasing
Trade Credit
IP Licensing and Acquisitions
Business Formation and Tax Structuring
Corporate Organization and Management
Partnership and LLC Organization and Management
Tax-Driven Entity Structuring
Charitable Organizations and Foundations
Real Estate Acquisition and Leasing
Real Estate Acquisition
Real Estate Leasing
Real Estate Finance (Acquisition)
Real Estate Finance (Construction)
Real Estate Entitlements
Real Estate State and Municipal Incentives
Mortgage Finance and Warehouse Finance
Whole Loan Transactions



Where the Lawyers Get Involved

Different Specializations for Different Stages

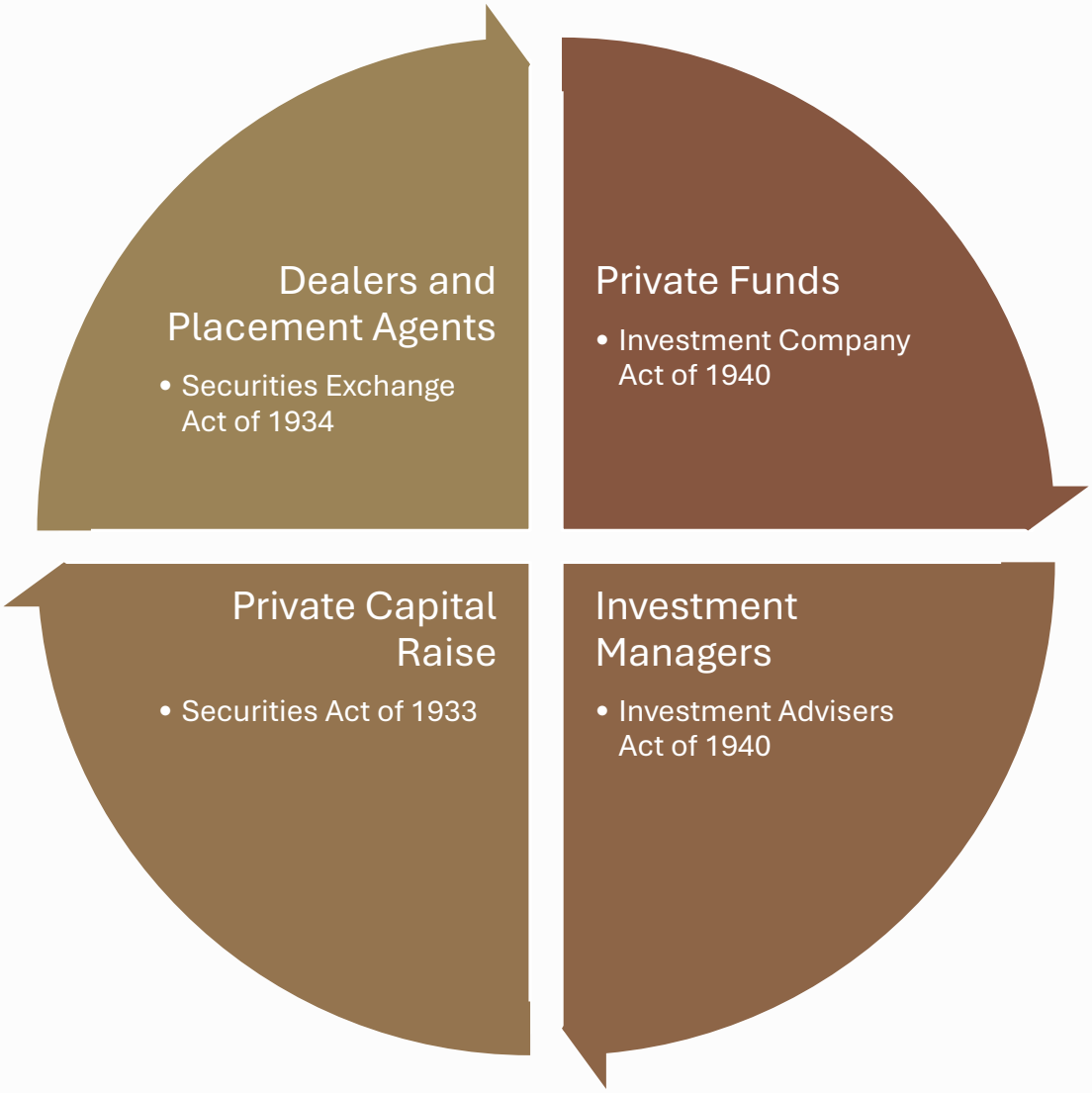


Company Fundraising Cycles

Identifying Investment Targets and Likely Capital Audience

Regulatory Quick Reference

The Key Rules and Regulations



The Regulatory Framework: Overview

The laws and regulations most directly affecting private equity funds and their investments, including:

- Investment Company Act of 1940
- Investment Advisers Act of 1940
- Securities Act of 1933
- Securities Exchange Act of 1934

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

Securities Act of 1933

Primary and Secondary Offerings

- The Securities Act requires registration of all securities offerings unless an exemption applies.
- Private funds rely heavily on Regulation D exemptions, especially Rule 506(b) (no general solicitation; unlimited accredited investors) and Rule 506(c) (public solicitation allowed if all investors are accredited).
- Managers must avoid “bad actor” disqualification, thoroughly document investor status, and meet disclosure requirements. Section 4(a)(2) allows non-public private placements, but Regulation D offers a clear “safe harbor.”
- Offshore offerings typically use Regulation S. Antifraud provisions (Section 17(a), Rule 10b-5) apply to all offers—even exempt ones—prohibiting misstatements or omissions of material facts.
- Funds must ensure compliance with general solicitation rules, use robust subscription agreements, and retain records to support exemption claims.
- Recent enforcement focuses on misrepresentations, accredited investor verification, and proper offering documentation.

Securities Exchange Act of 1934

Dealing and Market Making

- This Act regulates secondary market trading, periodic reporting, and anti-fraud standards.
- Investment advisers and private funds may have obligations under Section 13(g) (passive investment reporting for >5% stakes), Section 16 (reporting for insiders), and Section 15 (broker-dealer registration triggers).
- Rule 10b-5 prohibits fraud in connection with securities transactions—including unregistered fund interests.
- Funds with >$10 million in assets and certain securities may need to file Form 13F.
- Anti-fraud and anti-manipulation, including insider trading prohibitions, apply regardless of fund registration status.
- Exchange Act rules affect how advisers can communicate, trade, and aggregate ownership positions.
- Recent focus includes cybersecurity incidents, MNPI compliance, and regulation of digital assets offered through private funds.

Investment Company Act of 1940

A Private Fund or Investment Company?

- Funds must avoid regulated “investment company” status—so most private equity, venture, real estate, and hedge funds rely on Section 3(c)(1) (≤100 investors, no public offering) or 3(c)(7) (all investors are qualified purchasers).
- These exemptions limit investor type and count, requiring careful tracking and thorough subscription diligence.
- Section 3(c)(5) is used by funds primarily investing in mortgages/real estate.
- Registered investment companies (mutual funds) face strict requirements: independent boards, liquidity minimums, periodic reporting, and leverage limits.
- Missteps in exemption use can trigger registration, regulatory scrutiny, and enforcement action.
- Fund managers must periodically monitor compliance with investor thresholds, avoid indirect public marketing, and comply with all disclosures and governance principles.
- Current regulatory attention targets “shadow banking,” adviser-led restructuring, and new closed-end funds guidance.

Investment Advisers Act of 1940

Registered, Exempt and Unregistered Advisers

- Requires registration of advisers managing $100 million+ in assets, except for those qualifying for exemptions (private fund adviser, venture capital adviser).
- Imposes a fiduciary duty, mandates periodic Form ADV filings, compliance manual, robust recordkeeping, and policies for regulatory exams.
- Most state regulators require advisers below $100 million to register locally.
- Advisers must ensure suitability, fair dealing, manage conflicts, and disclose all material facts to clients. Recent SEC rules require advisers to publish marketing materials under Rule 206(4)-1.
- Exempt reporting advisers (ERAs) have diminished requirements but are still subject to anti-fraud rules and must file truncated Form ADV.
- Enforcement priorities include fee transparency, allocation of expenses, evaluation of cross trades, ESG representation, and cyber/IT controls.

Documentation of RIA Compliance Reviews

S7-03-22
November 8, 2024

Increasing Transparency:

- SEC rule S7-03-22 aims to increase transparency and investor protection in private funds.
- It requires private fund advisers to disclose detailed information on fees, expenses, and performance, and mandates annual financial statement audits.
- The rule also restricts certain fee and expense arrangements and requires fairness or valuation opinions for adviser-led secondary transactions.
- Additionally, it includes amendments to the Advisers Act compliance rule to facilitate SEC examinations
- Final Rule: https://www.sec.gov/comments/s7-03-22/s70322-20131146-301343.pdf
- Examples to follow…

Documentation of RIA Compliance Reviews

S7-03-22
November 8, 2024

Annual Compliance Review Documentation:

- The SEC now requires RIAs to document their annual compliance reviews in writing. This documentation must be made available to the SEC upon request, ensuring that firms maintain thorough records of their compliance activities.

Outsourcing Oversight:

- RIAs must conduct due diligence before retaining service providers for certain advisory functions. This includes periodic monitoring of the service provider's performance and obtaining reasonable assurances regarding their compliance with regulatory requirements.

Cybersecurity Risk Management:

- RIAs are required to adopt and implement written cybersecurity policies and procedures. These policies should address the identification, protection, detection, response, and recovery from cybersecurity threats. Additionally, RIAs must report significant cybersecurity incidents and publicly disclose cybersecurity risks and incidents in their brochures and registration statements.

Safeguarding Client Assets:

- The proposed rules expand the definition of custody to include discretion over client assets, not just funds and securities. This means RIAs must implement stricter controls and oversight to protect all types of client assets.

Conflicts of Interest with Predictive Data Analytics:

- The SEC is concerned about the potential for predictive data analytics and AI systems to favor registrants over investors. The proposed rules aim to address these conflicts of interest by requiring RIAs to implement policies and procedures that ensure fair treatment of all clients.

Internet Adviser Exemption

S7-13-23
March 27, 2024

Updates from 2002 Continue:

- The SEC's rule S7-13-23 amends the Advisers Act to exempt certain investment advisers providing advisory services through the internet from the prohibition on Commission registration.
- This rule modernizes the conditions for internet investment advisers, reflecting technological advancements and industry evolution since the rule's initial adoption in 2002.
- Key changes include requirements for operational interactive websites and digital investment advisory services, and the elimination of the de minimis non-internet client exception.
- The rule also includes amendments to Form ADV to align with these updates.
- Final Rule: https://www.sec.gov/rules-regulations/2024/03/s7-13-23#IA-6578final

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KEY LEGAL DOCUMENTS

Key Legal Documents

Regardless of the “physical structure”, the legal structure is created through recognizable agreements and documentation:

- LP/LLC Agreements
- Private placement memorandum
- Subscription booklets/agreements
- Articles of incorporation/memorandum and articles of Association (offshore only)
- Investment management agreement

Legal documents (cont.)

Other significant agreements

- Brokerage and custody agreement – sets forth the commission rates and the terms and conditions of other services provided to the fund.
- Investment advisor agreement – sets forth the fee structure and terms and conditions of operations between the fund and the investment adviser.
- Administration agreement – sets forth the fee structure, administrative responsibilities and the terms and conditions of operations between the fund and the administrator. Specifies the administrator's liability to the fund.
- ISDA master agreement – allows parties to aggregate amounts owed by each other under all the transactions covered by the agreement and replace them with a single net amount payable by one party to the other.

Other Common Service Providers

- Prime Broker
  - A special group of services that many brokerages give to special clients. The services provided are securities lending, leveraged trade executions, and cash management, among other things. A prime broker can also be a custodian.
- Custodian
  - A financial institution that has the legal responsibility for a customer's securities.

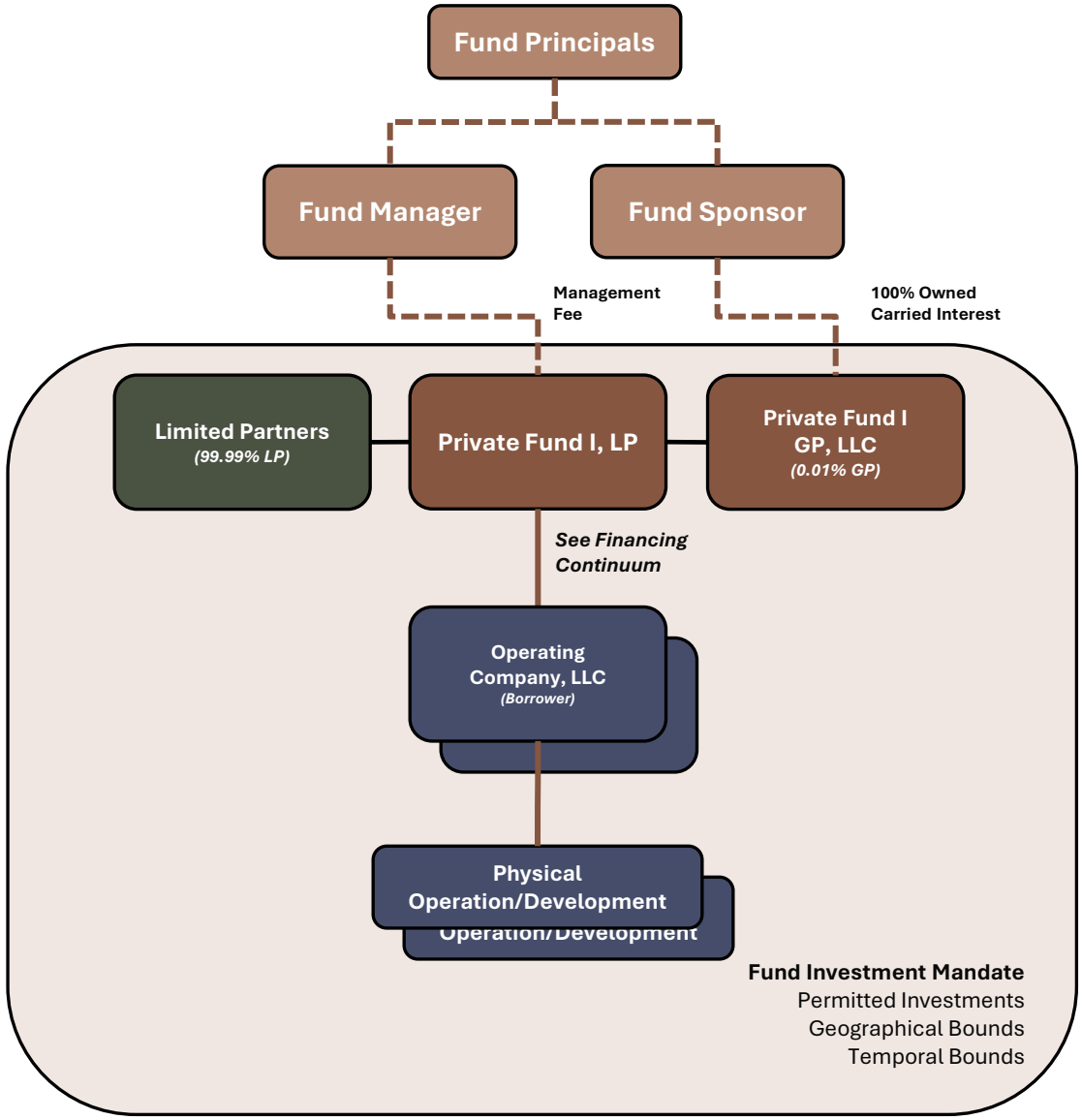
Administrator

- Maintain primary books and records
- Compute periodic NAVs and prepare reports to investors
- Maintain shareholder register and supporting documents and accept subscriptions/pay redemptions (transfer agency work)
- Liaise with regulators and handle filings
- Liaise with auditors, tax professionals and similar
- Often provide directors and officers for the fund (offshore) & may offer other services (banking, custody, valuation)
- Often have a “SSAE 16” Report for Service Organizations (SSAE 16)

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ECONOMICS (JUST THE BAICS)

The Traditional Private Equity Fund Structure



Basic Fund Economics

- Direct Investment/Buyout Funds
  - Management Fees
  - Carried Interest
  - Transaction Fees
- Hedge Funds
  - Management Fees
  - Performance Allocation/Performance Fees

Basic Fund Economics

- Management Fees
  - 1.5%-3% of Assets Under Management
  - Paid to Fund Manager under Management Agreement
- Carried Interest
  - 20%-30% of Profits on “Net Distributable Cash”
  - Paid to Fund Sponsor via Private Fund I GP, LLC
- Transaction Fees
  - 1%-5% of Invested Amount

Standard Deal Terms (Mezzanine)

Amount:	**$1-$100 million**
Interest Rate:	**Cash-Pay: 10% - 13%** **Deferred: 0% - 4%** **Total: 10% - 17%**
Return Enhancement:	**Warrants, put/conversion feature, plus tag-along, drag along and registration rights**
Targeted Return:	**15% – 22%**
Upfront Fee:	**1.0 – 2.0%**
Maturity:	**5 – 8 years**
Amortization:	**Bullet if shorter maturity (5 years) or back-end principal payments if longer maturity**
Security:	**Unsecured or second lien**
Financial Covenants:	**Typically mirror bank covenants but may be fewer and have more cushion**
Early Prepayments:	**Declining prepayment fee as a percentage of par (5%, 4%, 3%, 2%, 1%);** **may have initial no-call period**
Board Rights:	**Observation rights (occasionally Board seat)**

Standard Deal Terms (Mezzanine)

- Are the expectations of Lenders realistic where equity kickers are concerned? The easiest way to answer the question is to look at a typical exit scenario:
  - Original Investment:
    - Debt: $20,000,000
    - Interest: 10% per annum
    - Term: 5 years
    - Equity Kicker: Warrant (10% of common)
    - Pre-money Valuation: $25,000,000
    - Put Right: 5 years @ FMV
  - Motivators:
    - Cost of Capital: 4% per annum
    - Level of Risk: Medium-High

Standard Deal Terms (Mezzanine)

- Additional Assumptions:
  - Borrower Growth Rate: 15% per year
  - Exercise Price: Nominal
- Equity Kicker Payment:
  - FMV @ Maturity: $51,126,536
  - Put Option Proceeds: $5,126,536
  - Final IRR: 9.26%

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THANK YOU