



The JOBS Act: Hedge Funds, Start Your Engines!

The bill, which was signed into law by President Obama last week, loosens the binds that prevented hedge funds from advertising to attract new clients

It has been a relatively tough year for the world of alternative investments from a compliance and regulatory standpoint. A number of new initiatives, such as FATCA and [Form PE](#), have come to the forefront and have placed a sizeable burden on investment managers.

A new piece of legislation moving through the United States Congress, Jumpstart Our Business Startups (JOBS) Act, could provide some welcome relief for the alternative investment industry, both in how funds are marketed and a potential increase in the investor base.

One of the areas that potentially will experience an impact relates to the marketing of alternative investment vehicles. The JOBS Act, which is currently working its way through a second vote in the House of Representatives, aims to eliminate the ban on marketing private placements, which would include hedge funds and private equity funds. A signature from President Obama, officially signing it into law, could come pass by the time you read this and the President has already indicated he would sign such legislation if it came to his desk.

Under the current legislation, funds rely on Rule 506 to exempt their securities from registration and either Section 3(c)(1) or Section 3(c)(7) to exempt themselves from registration. However, these edicts also restrict a public offering and, in order to avoid breaching these rules, an issuer is required to have a pre-existing relationship with any prospective investors. In addition, the issuer also needs to have reason to believe rationally that the investor meets the qualification standards of an accredited or sophisticated investor.

The JOBS Act would mark a major shift in the advertising of alternative investment funds, which up until this point has been under heavy restrictions thanks to the Securities Act of 1933. Funds would now be able to market their offerings to a substantially larger audience and to a far greater degree than ever before. While no change is being made to the individuals or institutions that are permitted to invest in the funds, this relaxation of the general solicitation rules will greatly shift how funds are marketing to investors.

A second area of note, and one which is similarly receiving very little attention, is the increase in the number of "holders of record" in private funds. Currently, funds rely on Section 3(c)(7) of the Investment Company Act of 1940 to exempt themselves from registration, but this section also limits the number of holders in the fund to 499. Clearly, with the meteoric rise in the popularity of alternative investments, this limitation has become difficult for many funds, especially ones with large investor bases comprised of high net worth individuals. The JOBS Act will raise this threshold to 1,999 holders of record, quadrupling the potential investor base for a 3(c)(7) fund.

For many funds, this is a non-issue since their investor base does not eclipse 499 holders of record or has even come particularly close. However, for other large funds, there is the potential for opportunity. In the past, once a fund reached the threshold, the investment manager was often forced to launch additional fund vehicles and trade the entities in a side-by-side fashion. This led to a number of operational headaches, increased costs, and higher compliance requirements.

The four-fold increase in the permitted number of holders of record could, for some funds, be an opportunity to consolidate their entities under management into fewer fund vehicles. This could alleviate some of the operational knots that the middle and back office faces at both fund administrators and investment managers and, perhaps most importantly, result in decreased costs to investors and portfolio managers through the concentration of assets.

To be sure, the appeal of fewer audits, year-end financial statements, legal and compliance work, and a host of other tasks will be substantial.