U.S. Capital Raising

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What Israelis Should Know When Raising Private Funds in the U.S.

Introduction

The distribution of private fund interests in the U.S. by an Israeli asset manager or other non-U.S. asset manager ("Manager") raises a number of legal and regulatory issues. This article very briefly identifies and examines a number of the most important issues a Manager should consider when seeking to raise capital in the U.S. for a private fund.

U.S. Securities Laws

The two most significant U.S. federal securities laws governing the sale of interests in investment funds are the U.S. Securities Act of 1933, as amended (the "Securities Act"), and the U.S. Investment Company Act of 1940, as amended (the "Investment Company Act").

As a result, issuers seeking to rely on Regulation D need to diligence persons associated with the securities offering to ensure the issuer is not disqualified from issuing its securities under Regulation D.

The Securities Act

Section 5 of the Securities Act generally requires the registration of any security offered or sold through the use of any means of U.S. interstate or international commerce. Section 4(a)(2) of the Securities Act and Regulation D thereunder provide a private placement exemption from Securities Act registration, provided that the offer or sale does not involve a public offering. The facts and circumstances surrounding an offering will be relevant in determining whether it is public or private, including, without limitation, the manner of the offering, the number of offerees and their relationship to the issuer and the sophistication of the offerees. Rule 506 of Regulation D provides a "safe harbor" under Section 4(a)(2) of the Securities Act, provided that (i) sales are made only to "accredited investors" (e.g., individuals with a net worth exceeding US$1 million (excluding the value of his or her primary residence) and entities that are beneficially owned by accredited investors); (ii) there is no general solicitation or advertising involved with the offering; and (iii) investors buy the securities for investment and not for resale.

With respect to the general solicitation / advertising prong of Regulation D, in 2013, the SEC adopted Rule 506(c), which permits general solicitation and general advertising while still staying within the confines of the Regulation D private placement exemption.

In addition, in 2013 the SEC also adopted Rule 506(d) of Regulation D under the Securities Act which disqualifies securities offerings involving certain felons and other 'bad actors'. As a result, issuers seeking to rely on Regulation D need to diligence persons associated with the securities offering to ensure the issuer is not disqualified from issuing its securities under Regulation D.

Investment Company Act

A non-U.S. private fund that seeks to admit U.S. persons generally will need to rely on the exceptions to investment company status set forth in Sections 3(c)(1) and 3(c)(7) of the Investment Company Act in order to avoid registration thereunder.

Under Section 3(c)(1), a non-U.S. fund must meet the following requirements:

(a) the outstanding securities of the fund must not be beneficially owned by more than 100 U.S. persons; and

(b) the fund must not make or propose to make a public offering of its securities in the U.S.

For purposes of counting investors to avoid breaching the 100 U.S. person limit, it may be necessary to "look through" to the underlying beneficial owners of certain investors (e.g., entities that are formed for the purpose of investing in the private fund).

Under Section 3(c)(7), a non-U.S. fund must meet the following requirements:

(a) the fund must not make or propose to make a public offering of its securities in the U.S.; and

(b) the U.S. beneficial owners must be limited to "qualified purchasers".

"Qualified purchasers" include, for example, individuals who own at least US$5 million in "investments" (as defined under the Investment Company Act) and entities that are beneficially owned by qualified purchasers.

For purposes of counting investors to avoid breaching the 100 U.S. person limit, it may be necessary to "look through" to the underlying beneficial owners of certain investors (e.g., entities that are formed for the purpose of investing in the private fund).

U.S. Investment Advisers Act of 1940

The two primary exemptions from registration that may be available to a Manager seeking to avoid registering with the SEC as an investment adviser under the Advisers Act are:

(a) Foreign Private Adviser Exemption. To qualify, the Manager must: (i) have no place of business in the U.S.; (ii) have fewer than 15 clients and investors in the U.S. in private funds advised by the Manager; (iii) have aggregate assets under management of less than US$25 million attributable to clients in the U.S. including U.S. domiciled private funds and U.S. investors in private funds advised by the Manager; (iv) not hold itself out generally to the public in the U.S. as an investment adviser; and (v) not advise registered investment companies or business development companies.

(b) Private Fund Adviser Exemption. To qualify for this exemption, the Manager must (i) act solely as an adviser to qualifying private funds (i.e., Section 3(c)(1) or 3(c)(7) funds); and (ii) have assets under management in the U.S. of less than US$150 million.

To the extent the Manager cannot satisfy either of these exemptions but advises investment funds that run a venture capital, real estate or commodity strategy, there may be additional exemptions from SEC registration on which the Manager can rely. Please note that a Manager that operates under the exemption set forth in (b) above would need to file with the SEC as an exempt reporting adviser.

Other Considerations

If an investment fund utilizes commodity interests (e.g., certain derivative instruments) for investment or hedging purposes, the Manager (or other relevant person(s)) may be required to register with the CFTC as a commodity pool operator and/or a commodity trading advisor, unless exemptions are available.

Any Israeli asset manager contemplating an offering of fund interests in the U.S. should engage legal counsel in advance to assist it in navigating the various legal and regulatory issues that such offering will entail.

In addition, if a private fund sells its securities to U.S. residents directly, rather than through a registered broker-dealer, the private fund typically relies on the non-exclusive safe harbor set forth in Rule 3a4-1 of the Securities Exchange Act of 1934, as amended (the so-called "issuer exemption"), which permits certain "associated persons" of the fund to participate in the sale of an issuer's securities without being considered a broker, provided that certain criteria are met.

Conclusion

Any Israeli asset manager contemplating an offering of fund interests in the U.S. should engage legal counsel in advance to assist it in navigating the various legal and regulatory issues that such offering will entail. Counsel will also be able to assist with any filings required as a consequence of marketing activities in the U.S.

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As Israeli companies continue to be attracted to the American market—and as U.S. investors, in turn, covet cutting-edge Israeli technologies—our Israel practice group continues to assist parties from both countries. We have over two decades' experience helping Israeli companies enter U.S. markets and engage in deals with U.S. investors and partners. We regularly handle strategic transactions on behalf of both public and private Israeli entities, and we have been instrumental in a large number of public equity financings of U.S.-listed Israeli companies.

We have long enjoyed deep ties to the Israeli business community, and our strong relationships with Israeli legal and accounting firms make us ideal partners in the structuring of a variety of M&A and capital markets transactions for the American market. We are sensitive to the differences in the two business cultures, and have grown adept at translating between them.

What needs no translation is the pragmatic, "get-it-done" approach we bring to all our transactions firm-wide—an approach very much attuned to the results-oriented predispositions of our Israeli clients.
Chambers Global (2015) selected Kramer Levin's Israel practice as one of the best in the legal field in the area of Corporate/M&A: Foreign Experts (Based Abroad). Clients remarked that "[Kramer Levin] has a very long pedigree of working with Israeli companies."
Drawing from the various disciplines within the firm, our services include:
Capital markets transactions; Early stage representation; Fund formation; Intellectual property and technology law; Labor and executive compensation law; Litigation; Mergers and acquisitions; Securities law compliance; Taxation.

Kevin P. Scanlan is the chair of Kramer Levin's Private Funds practice. He advises clients on structuring, forming and investing in international and domestic private investment funds, including hedge funds, private equity funds, real estate funds, venture capital funds and fund-of-funds. In addition, Mr. Scanlan advises funds in connection with their subsequent investment activities. He represents large, well-established funds and managers as well as first-time funds of high-quality emerging managers.

Mr. Scanlan is a member of the Managed Funds Association Outside Counsel Forum and the New York State Bar Association Private Investment Funds Subcommittee, as well as a Faculty Professor of the Regulatory Compliance Association's CCO University. In 2014, Mr. Scanlan received The American Lawyer's "Global Pro Bono Deal of the Year, Social Enterprise." The award recognized his work as lead partner on a transaction involving the establishment of an investment fund and the structuring of an innovative loan made by the fund to smallholder farmers in the cacao industry in Belize. Mr. Scanlan was named one of Institutional Investor News' "Rising Stars of Hedge Funds" in 2009 and is recommended by The Legal 500 (US) in the area of alternative/hedge funds.

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