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United States

Alternative Investment Funds

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This country-specific Q&A provides an overview of alternative investment funds laws and regulations applicable in United States.

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United States: Alternative Investment Funds

1. What are the principal legal structures used for Alternative Investment Funds?

Privately offered alternative investment funds ("AIFs") are established in the United States ("U.S.") pursuant to U.S. state law. It is most common to organize an AIF under state law as a limited partnership ("LP") or a limited liability company ("LLC"), with the substantial majority organized as LPs. Sponsors primarily organize AIFs in the State of Delaware, because it is a jurisdiction deemed by many industry participants to have pro-management laws, a sophisticated Court of Chancery as to corporate matters, and a well-established related body of statutory and case law.

In addition, it is common for AIFs that are organized in a non-U.S. jurisdiction (*e.g.*, the Cayman Islands, British Virgin Islands, or Bermuda) to be marketed in the U.S. For purposes of this survey, we will primarily refer to the laws of the State of Delaware in connection with the organization, structure, and operation of an AIF sold to U.S. residents.

2. Does a structure provide limited liability to the investors? If so, how is this achieved?

Under Delaware law, provided an investor is not actively involved in the management or operations of an AIF, the investor has limited liability. AIF governing documents typically provide that investors do not have any rights over the day-to-day management or operations of the AIF. Accordingly, a passive investor's maximum loss is limited to the total amount of its investment.

3. Is there a market preference and/or most preferred structure? Does it depend on asset class or investment strategy?

A Delaware LP is the traditional and most common vehicle for establishing an AIF in the U.S. across multiple asset classes and investment strategies, offering the most developed body of law in Delaware and the most familiarity among investors. A Delaware LLC is the second most common option.

It is common for sponsors to form a non-U.S. AIF as a corporate tax blocker for certain non-U.S. investors and/or U.S. tax-exempt investors. Where appropriate, the non-U.S. AIF, along with the U.S. AIF, will frequently serve as "feeder funds" in a "master-feeder" fund structure, investing a substantial portion (if not substantially all) of their investable assets through a common "master fund", typically a non-U.S. AIF classified as a partnership for U.S. tax purposes.

4. Does the regulatory regime distinguish between open-ended and closed-ended Alternative Investment Funds (or otherwise differentiate between different types of funds or strategies (e.g. private equity vs. hedge)) and, if so, how?

No, an AIF can be open-ended or closed-ended. Typically, the decision will hinge on the liquidity profile of its anticipated investments and liquidity expectations of its prospective investors.

5. Are there any limits on the manager's ability to restrict redemptions? What factors determine the degree of liquidity that a manager offers investors of an Alternative Investment Fund?

No, there are no restrictions or limitations beyond those in the AIF's governing documents. The liquidity profile of an AIF is primarily determined by the expected liquidity of its underlying assets. U.S. federal law and Delaware state law do not limit how investor redemptions may be effected or restricted, but the sponsor and manager must comply with federal and state fiduciary and anti-fraud principles when making decisions, including as to investor redemptions (see Item 8 below).

6. What are potential tools that a manager may use to manage illiquidity risks regarding the portfolio of its Alternative Investment Fund?

Potential tools to manage illiquidity risks include redemption notice periods, redemption fees, investor and/or fund-level redemption gates, lock-up periods, temporary suspension of redemptions, redemptions in-kind, slow pay provisions, and side pockets, all of which should be detailed in the AIF's governing documents.

7. Are there any restrictions on transfers of investors' interests?

Yes. Under Rule 502(d) of Regulation D under the U.S. Securities Act of 1933, as amended (the "Securities Act"), securities acquired in a private placement under Regulation D may not be resold by an investor without registration under the Securities Act or an exemption therefrom. To rely on Regulation D, an AIF must exercise reasonable care to assure that investors are not acquiring interests in the AIF with a view to redistributing them publicly. Accordingly, it is market practice for AIF governing documents to require the prior written consent of the sponsor for transfers of interests in the AIF.

8. Are there any other limitations on a manager's ability to manage its funds (e.g., diversification requirements)?

No, there are no limitations beyond those in the AIF governing documents. Under the U.S. Investment Advisers Act of 1940, as amended ("Advisers Act"), however, an investment adviser owes a fiduciary duty to its clients. The fiduciary duty is comprised of a duty of care and a duty of loyalty. This means that the adviser must serve the client's best interests at all times and avoid subordinating the client's interests to its own. Additionally, the adviser must eliminate or make full and fair disclosure of all conflicts of interest and otherwise comply with the anti-fraud provisions of the Advisers Act, as well as any applicable state fiduciary and anti-fraud provisions.

9. What is the local tax treatment of (a) resident, (b) non-resident, (c) pension fund and (d) sovereign wealth fund investors (or any other common investor type) in Alternative Investment Funds? Does the tax status or preference of investors or the tax treatment of the target investments primarily dictate the structure of the Alternative Investment Fund?

U.S. citizens and residents are subject to taxation on their worldwide income. Non-residents are taxable directly on net income derived in connection with U.S. trade or business activity and through withholding on the gross amount of dividends and other categories of U.S. source income not connected with a U.S. trade or business. Non-residents may be unwilling to invest in a U.S. pass-through entity due to sensitivity around receiving a Schedule K-1. U.S. tax-exempt investors generally are taxable only on income derived from (i) a business that is unrelated to their exempt purpose (with certain exclusions) or (ii) debt-financed property. Investor tax status or preferences and target investments can influence the AIF's structure.

10. What rights do investors typically have and what restrictions are investors typically subject to with respect to the management or operations of the Alternative Investment Fund?

Investors typically do not have any rights over an AIF's day-to-day management or operations. Some AIF governing documents, however, may allow investors, under limited circumstances and with a majority or supermajority vote, to remove the sponsor or manager, terminate the AIF, or suspend additional investments. In addition, pursuant to its fiduciary duty under the Advisers Act, an investment adviser should consider obtaining the prior consent of investors (or an advisory board comprised of investor representatives) for certain transactions or arrangements involving conflicts of interest.

11. Where customization of Alternative Investment Funds is required by investors, what types of legal structures are most commonly used?

If, for certain reasons, a separate arrangement is required to meet specific investor needs, the arrangement is typically structured as a feeder fund, a parallel fund, a fund-of-one, or a separately managed account. Funds are usually formed as LPs, LLCs, or corporations, depending on the circumstances.

12. Are managers or advisers to Alternative Investment Funds required to be licensed, authorised or regulated by a regulatory body?

Yes. The Advisers Act generally requires persons that meet the definition of an "investment adviser" (as defined in Advisers Act Section 202(a)(11)) to register with the U.S. Securities and Exchange Commission ("SEC"), unless an exemption applies. Two exemptions are particularly useful to advisers managing AIFs marketed in the U.S.

Foreign Private Adviser Exemption: Under Advisers Act Section 202(a)(30), a "foreign private adviser" is defined as an investment adviser that: (i) has no place of business in the U.S.; (ii) has, in total, fewer than 15 U.S.

clients and U.S. investors in private funds advised by the investment adviser (such clients and investors, "U.S. Persons"); (iii) has aggregate assets under management attributable to U.S. Persons of less than $25 million; and (iv) neither (a) holds itself out generally to the public in the U.S. as an investment adviser, nor (b) advises investment companies or business development companies registered under the U.S. Investment Company Act of 1940, as amended ("Company Act").

Private Fund Adviser Exemption: An exemption exists for investment advisers that solely manage "private funds" (and not, for example, separately managed accounts for U.S. persons) with assets under management in the U.S. of less than $150 million. In applying this exemption, Rule 203(m)-1 under the Advisers Act requires non-U.S. advisers (that is, advisers with their "principal office and place of business" outside the U.S.) to count only private fund assets that are managed from a "place of business" within the U.S. toward the $150 million threshold (while it requires U.S. advisers to consider all of their asset management activities worldwide). A non-U.S. adviser can qualify for this exemption regardless of the size or nature of its activities outside of the U.S., provided that all of its clients that are U.S. Persons are qualifying private funds (as defined by the exemption).

Investment advisers that rely on the "private fund adviser" exemption are called "exempt reporting advisers" under SEC rules and, as such, are required to submit to the SEC and update at least annually, certain reports on Part 1 of Form ADV. These advisers are subject to a limited subset of rules and regulations under the Advisers Act, including the SEC's pay-to-play rule (see Item 32 below).

In addition, the sponsor or manager of an AIF that makes use of commodity futures, commodity options contracts, and/or certain swaps ("Commodity Interests") may need to register as a commodity pool operator ("CPO") and/or a commodity trading adviser ("CTA") with the Commodity Futures Trading Commission ("CFTC") and National Futures Association. AIF sponsors and managers often rely on the CPO registration exemption under CFTC Regulation 4.13(a)(3), which requires the AIF to limit its use of Commodity Interests to specified thresholds. Related exemptions are also available to avoid CTA registration.

13. Are Alternative Investment Funds themselves required to be licensed, authorised or regulated by a regulatory body?

Generally speaking, AIFs that are privately offered in the U.S. are structured in reliance on Section 3(c)(1) or 3(c)(7) of the Company Act, each of which provides an exemption from registration as an investment company with the SEC under the Company Act. Sections 3(c)(1) and 3(c)(7) prohibit the AIF from conducting a public offering of its securities in the U.S. Under Section 3(c)(1), the AIF is limited to no more than 100 beneficial owners, excluding "knowledgeable employees" as defined in Rule 3c-5 under the Company Act ("Knowledgeable Employees"). Section 3(c)(7) imposes no cap on the number of beneficial owners but restricts investors to those who qualify as "qualified purchasers", excluding Knowledgeable Employees (see Item 31).

In general, for U.S. AIFs, all investors are required to meet these requirements; for non-U.S. AIFs, only U.S. investors are required to meet the requirements.

14. Does the Alternative Investment Fund require a manager or advisor to be domiciled in the same jurisdiction as the Alternative Investment Fund itself?

No.

15. Are there local residence or other local qualification or substance requirements for the Alternative Investment Fund and/or the manager and/or the advisor to the fund?

No, but Delaware LPs and LLCs must appoint an agent for service of process in Delaware and make required local tax filings. An AIF's investment manager typically qualifies to do business in the state of its principal place of business and may also need to qualify to do business in the state in which the AIF is domiciled or has its principal place of business, as required by applicable state law.

16. What service providers are required by applicable law and regulation?

An AIF generally engages an investment manager, administrator, custodian, and auditor. Certain AIFs also appoint prime (and executing) brokers and/or independent valuation agents. AIFs formed as corporations must appoint directors, at least one of whom is typically independent.

17. Are local resident directors / trustees

required?

No.

18. What rules apply to foreign managers or advisers wishing to manage, advise, or otherwise operate funds domiciled in your jurisdiction?

Foreign managers and advisers that operate AIFs in the U.S. must either register as investment advisers with the SEC or qualify for an exemption (see Item 12 above). Similarly, foreign managers and advisers of AIFs investing in Commodity Interests must comply with CFTC rules and regulations, including CPO or CTA registration unless an exemption applies (see Item 12 above).

19. What are the common enforcement risks that managers face with respect to the management of their Alternative Investment Funds?

The SEC's Division of Examinations publishes annual examination priorities and periodic risk alerts identifying the areas it believes present potential risks to investors. Common themes include failure to disclose conflicts of interest, improper allocation of fees and expenses, deficient information security protections, and deficient policies and procedures related to material nonpublic information.

20. What is the typical level of management fee paid? Does it vary by asset type?

The range of "market" management fee rates vary, depending on the AIF's size and strategy. In practice, we typically see the rate ranging, on average, from 1.0% to 2.0% of the AIF's net asset value.

21. Is a performance fee or carried interest typical? If so, does it commonly include a "high water mark", "hurdle", "water-fall", "preferred return" or other condition? If so, please explain.

Yes, performance-based compensation varies based on tax implications and typically takes the form of a "performance fee" or a "performance allocation"/"carried interest", on average often ranging from 15% to 20% of the AIF's net profits.

Open-ended AIFs typically charge performance fees or allocations annually on both realized and unrealized gains and are commonly subject to a "high water mark" (or "loss carryforward"), ensuring fees or allocations are only charged if the AIF's net asset value exceeds the previous highest net asset value achieved by the AIF. Based on the AIF's strategy and investor expectations, the AIF may also need to exceed an additional hurdle (e.g., a rate of 5% of the AIF's opening net asset value for the year or the annual performance of a relevant stock index or other benchmark) beyond the high water mark. A portion of the accrued fee or allocation is typically crystallized upon investor withdrawal or redemption. For side pockets or slow pay accounts, performance fees or allocations are calculated solely on realized gains.

Closed-ended AIFs typically charge carried interest pursuant to a "distribution waterfall", where proceeds from realized investments are distributed to investors and the sponsor based on an established priority set forth in the AIF's governing documents. The waterfall typically includes a "preferred return" ensuring investors receive a minimum return before the sponsor may begin receiving carried interest.

22. Are fee discounts / fee rebates or other economic benefits for initial investors typical in raising assets for new fund launches?

Yes, this is typical for certain AIFs whose sponsors aim to enhance fundraising efforts. This may be structured as a separate share class (e.g., a "founders class").

23. Are management fee "break-points" offered based on investment size?

Reduced or tiered management fee rates may be given based on investment size, strategic relationship status, and/or early investment.

24. Are first loss programs used as a source of capital (i.e., a managed account into which the manager contributes approximately 10-20% of the account balance and the remainder is furnished by the investor)?

No, but a first loss program could serve as a practical initial or intermediate step for a smaller sponsor seeking to build a track record of managing external capital before launching a commingled AIF.

25. What are the typical terms of a seeding / acceleration program?

A seed investment deal between a new AIF sponsor and a seed investor (typically a large institution) can be a key first step in launching a first fund, including one for a new strategy or business line. In a typical deal, the seed investor commits to a founding investment in exchange for a share of the sponsor's future revenues or profits.

Key terms of seed deals vary significantly, but generally include: (i) a sizeable investment by the seed investor, subject to an agreed lock-up period and exceptions (e.g., underperformance against an agreed benchmark; (ii) put and call options for both the seed investor and sponsor; (iii) capacity rights for the seed investor; (iv) the sponsor and key principals committing to make and maintain an agreed minimum investment in the fund; (v) working capital support for the sponsor; (vi) restrictive covenants on the sponsor's key principals; and (vi) most favored nations protection for the seed investor.

An acceleration program works similarly but focuses on existing AIFs seeking to accelerate asset growth, often with fewer or modified terms.

26. What industry trends have recently developed regarding management fees and incentive/performance fees or carried interest? In particular, are there industry norms between primary funds and secondary funds?

We have recently seen a downward pressure from 2.0% management fee rates and 20% incentive/performance fee or carried interest rates charged by primary AIFs. With respect to secondary AIFs, in a typical structure, an investor is charged a management fee and incentive/performance fee or carried interest by the AIF, which, in turn, must pay a fee to the sponsor of the acquired underlying fund interests.

27. What restrictions are there on marketing Alternative Investment Funds?

An AIF must be offered and sold in the U.S. pursuant to a private placement for its securities to be exempt from registration under the Securities Act.

Private placements by AIFs are typically made under the Rule 506(b) safe harbor of Regulation D, which permits sales to an unlimited number of "accredited investors" (see Item 31 below) and up to 35 non-accredited investors (although the sale to non-accredited investors triggers additional disclosure requirements and generally is less common among institutional sponsors). To rely on this safe harbor, (i) no general solicitation or advertising may occur, and (ii) reasonable resale restrictions must be imposed.

Private placements issued by AIFs have less commonly been made under the Rule 506(c) safe harbor of Regulation D, which permits general solicitation and general advertising. To rely on this safe harbor (among other requirements), reasonable steps must be made to verify that the purchasers are accredited investors. On March 12, 2025, however, the SEC staff provided no-action relief to expand the methods available to verify that the purchasers are accredited investors. Specifically, funds with a minimum investment amount of $200,000 for natural persons or $1,000,000 for legal entities can obtain written representations (i) regarding the purchaser's accredited investor status and (ii) that the investment is not third-party financed to verify that the purchasers are accredited investors. As a result, it is expected that private placements by AIFs made under Rule 506(c) will become more common over time.

In addition, Regulation D also technically requires an AIF to file a short notice (a Form D) with the SEC within 15 days of the first sale of interests to U.S. investors. On September 27, 2024, the SEC amended the rules and forms governing the EDGAR (Electronic Data Gathering, Analysis, and Retrieval) filing system. The amendment became effective on March 21, 2025. The new system, referred to as "EDGAR Next", replaces the old password-based access system with enhanced security features. Existing filers with password-based access credentials as of March 21 must comply by September 12, 2025, using a simplified enrollment procedure. They can then use both the existing password-based access credentials and the new EDGAR Next credentials until September 12, 2025. All other applicants must comply immediately. EDGAR Next limits filing access to persons specifically authorized by the filer, and the SEC can trace filings to specific users. Login credentials are required for all persons accessing the filer's dashboard or submitting filings on behalf of the filer, and credentials may not be shared. Filers must designate "account administrators", "technical administrators", and "users" to act in specific roles. Also, annual confirmations and other compliance measures are now mandatory.

28. Is the concept of "pre-marketing" (or equivalent) recognised in your jurisdiction? If so, how has it been defined (by law and/or practice)?

No.

29. Can Alternative Investment Funds be marketed to retail investors?

No.

30. Does your jurisdiction have a particular form of Alternative Investment Fund be that can be marketed to retail investors (e.g. a Long-Term Investment Fund or Non-UCITS Retail Scheme)?

No.

31. What are the minimum investor qualification requirements for an Alternative Investment Fund? Does this vary by asset class (e.g. hedge vs. private equity)?

All investors in an AIF generally must qualify as "accredited investors" as defined in Rule 501(a) under the Securities Act. In general, an "accredited investor" includes: (i) a natural person whose net worth (or joint net worth with that person's spouse or spousal equivalent) exceeds $1 million (excluding the value of the individual's primary residence), or whose income was in excess of $200,000 in each of the preceding two years (or, together with that person's spouse or spousal equivalent, in excess of $300,000 in each of the preceding two years) and who reasonably expects to reach the same level of income in the current year; (ii) a natural person holding in good standing a Series 7, 65, and/or 82 license and/or such other professional certification(s) or designation(s) or credential(s) from an accredited educational institution that the SEC has designated as qualifying an individual for accredited investor status; (iii) a natural person who is a Knowledgeable Employee; (iv) any entity not formed solely for the specific purpose of acquiring the securities offered and has total assets in excess of $5 million; and (v) any entity in which all of the equity owners are accredited investors.

In addition, investors in AIFs relying on the Section 3(c)(7) exemption from registration under the Company Act must meet the definition of a "qualified purchaser", which generally includes: (i) a natural person who owns at least $5 million in investments; (ii) a natural person who is a Knowledgeable Employee; (iii) any entity not formed solely for the specific purpose of acquiring the securities offered with at least $5 million in investments and which is owned by certain related individuals (generally immediate family members) or by a trust or foundation established for the benefit of such related persons; (iv) any person, acting for its own account or the accounts of other qualified purchasers, who in the aggregate owns and invests on a discretionary basis not less than $25 million in investments and was not formed solely for the specific purpose of acquiring the securities offered; and (v) any company for which each beneficial owner of the company's securities is a qualified purchaser. For these purposes, the term "investments" includes real estate held for investment purpose. Real estate will not be deemed to be held for investment purposes if it used for personal purposes or as a place of business or in connection with the conduct of the trade or business, except where the person or entity is engaged primarily in the business of investing, trading or developing real estate, in which case real estate owned in connection with such business may be deemed held for investment purposes.

Further, Section 205(a)(1) of the Advisers Act prohibits a registered investment adviser from entering into performance fee arrangement with a client, unless an exemption applies. Advisers frequently rely on Advisers Act Rule 205-3, which provides an exemption from the performance fee prohibition to an adviser that enters into a performance fee arrangement with "qualified clients", which generally include: (i) natural persons or companies that have at least $1.1 million under management with the adviser immediately after entering into the contract: (ii) natural persons or companies that either have a net worth of more than $2.2 million (excluding the value of their primary residence) at the time the contract is entered or are qualified purchasers (see above); and (iii) natural persons who are Knowledgeable Employees. A company that satisfies the dollar requirement above is a qualified client, unless it is (i) a fund relying on the Section 3(c)(1) exemption from registration under the Company Act, (ii) an investment company registered under the Company Act, or (iii) a business development company (as defined in Section 202(a)(22) of the Advisers Act), in which case the company is not a qualified client unless each of its equity owners (other than the adviser or owners not charged a performance fee) could otherwise enter into a performance fee arrangement under the rule. Funds relying on the Section 3(c)(7) exemption from registration under the Company Act are not subject to this "look-through" rule.

In general, for U.S. AIFs, all investors must meet these qualification requirements; for non-U.S. AIFs, only U.S. investors must meet the requirements.

32. Are there additional restrictions on marketing to government entities or similar investors (e.g.

sovereign wealth funds) or pension funds or insurance company investors?

The SEC has adopted the "pay-to-play" rule (Rule 206(4)-5 under the Advisers Act) that prohibits investment advisers from providing advisory services for compensation to a government entity (which includes managing an AIF in which the government entity is an investor) within two years following a contribution to an official of the government entity by the adviser or certain "covered associates".

In addition, many states have adopted similar rules and regulations.

33. Are there any restrictions on the use of intermediaries to assist in the fundraising process?

Offering and selling interests in an AIF in the U.S. generally requires that the AIF engage an entity that is registered as a broker-dealer with the SEC and that is a member of the Financial Industry Regulatory Authority (FINRA). The licensed broker-dealer may be either an affiliate of the AIF sponsor or an independent third-party. Some AIF sponsors rely on the so-called "issuer exemption" or similar guidance. The SEC has adopted a safe harbor under Rule 3a4-1 under the Exchange Act, which deems persons within the rule to be eligible for the exemption, but the precise contours of this exemption are unclear.

34. Is the use of "side letters" restricted?

No, the use of side letters is not currently restricted under applicable U.S. federal or Delaware state law.

35. Are there any disclosure requirements with respect to side letters?

There are no express disclosure requirements under U.S. federal or state law with respect to side letters. From a conflicts disclosure and overall fiduciary duty perspective, however, investment advisers should include disclosure in the offering memorandum for an AIF that side letters may be entered into which result in preferential treatment for certain investors over others.

36. What are the most common side letter terms? What industry trends have recently developed regarding side letter terms?

The most common side letter terms include most favored nations protection, reduced or modified fees, preferential redemption rights, transfer rights, enhanced reporting, and confidentiality.

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