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Hedge Fund Law Report
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Why and How Do Hedge Fund Managers Set Minimum Subscription Amounts? (Part Two of Two)

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By Lily Chang, *Hedge Fund Law Report*

Minimum subscription amounts do more than govern the dollar threshold required for access to a hedge fund. In addition, minimums communicate information about the manager's strategy and goals; inform the composition of the investor base; enable and limit performance; impact the pace and productivity of marketing; and constrain fund liquidity. This is the second article in a two-part series digging deeply into the important but often overlooked topic of hedge fund investment minimums. Generally, this article explores market practice in this area. Specifically, this article discusses the market for investment minimums and related terms; trends with respect to minimums; application of minimums in different factual contexts; whether investment minimums apply to follow-on investments; and manager practice for enforcing, waiving and modifying minimums. The first article in this series addressed primary legal, business and investment rationales for setting hedge fund investment minimums. See "Why and How Do Hedge Fund Managers Set Minimum Subscription Amounts? (Part One of Two)," Hedge Fund Law Report, Vol. 6, No. 23 (Jun. 6, 2013).

Market for Minimum Subscription Amounts

A recent Seward & Kissel study of hedge fund launches in 2012 reflected a wide range of minimum subscription amounts set by hedge fund managers launching their maiden funds. See "Seward & Kissel Study of New Hedge Fund Launches Identifies Trends in Preferred Investment Strategies, Fees, Liquidity Terms, Fund Structures and Strategic Capital Arrangements," Hedge Fund Law Report, Vol. 6, No. 15 (Apr. 11, 2013). While approximately 70% of hedge funds maintained a minimum subscription amount of $1 million, some hedge funds opted for a minimum subscription amount as low as $250,000 while others opted for a minimum subscription amount as high as $5 million. Daren Domina, a partner at Haynes & Boone, LLP, confirmed these findings, commenting, "a majority of new funds start that discussion with a $1 million minimum subscription amount." Matthew Eisenberg, a partner at Finn Dixon & Herling LLP, has noticed the same starting point as well as a wide range for minimum subscription amounts. "For open-ended, privately offered funds, probably the most common minimum subscription amount is $1 million, but the range that we most commonly see is $100,000 to $5 million," Eisenberg said. "Five million dollars would normally be for a 3(c)(7) fund that's institutionally focused, and as you start to go down the ladder in terms of minimum dollar amounts, the target audience tends to slowly gravitate more towards high net worth individuals."

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However, Kay Gordon, a partner at Drinker Biddle & Reath LLP, pointed out that investment minimums at the far ends of the spectrum are becoming less common. "We are seeing fewer $100,000 minimums because the smaller start-up managers find it more difficult to launch funds in this credit, regulatory and economic environment. Yet, we are also seeing fewer $5 million minimums because now, even those managers who were previously targeting a select group of investors try to reach wider categories of investors. So they are lowering their minimum subscription amounts. It goes both ways." For a discussion on the challenges that managers with lower AUM have in raising capital, see "SEI Study Offers a Reality Check to Hedge Fund Managers on What Actually Works When Marketing to Institutional Investors," Hedge Fund Law Report, Vol. 6, No. 15 (Apr. 11, 2013).

Trends in Setting Minimum Subscription Amounts

While $1 million appears to represent the most common minimum subscription amount, this has not always been the case. Minimum subscription amounts, according to Janet Murtha, a partner at Wuersch & Gering LLP, have risen over time. Murtha reflected, "When I first started doing this in 1998, I remember people starting funds with a couple million dollars, and some of those funds had extremely low minimums. However, in the current market environment, that just does not work anymore. There is too much overhead; too many costs involved to make it worthwhile to run very small funds. The same thing happens with managed accounts. If instead of running a fund, a manager opts to run managed accounts for several people, that manager likely would not want to run 50 different managed accounts of $500,000. This is because then, at the end of the day, the manager would really not be managing that much money. However, they would be running a whole bunch of different accounts that, more likely than not, are traded somewhat differently. It just becomes too difficult. So minimums have increased. The regulatory standards have increased too. You need more money to be an accredited investor and a qualified client." See "Citi Prime Finance Report Dissects the Expenses of Running a Hedge Fund Management Business, Identifying Components, Levels, Trends and Benchmarks," Hedge Fund Law Report, Vol. 6, No. 1 (Jan. 3, 2013).

The institutionalization of the hedge fund investor base within the past few years generally has impacted the setting of minimum subscription amounts. As Martin Sklar, a partner at Kleinberg, Kaplan, Wolff & Cohen, P.C., observed, "The new funds tend to be larger institutional funds. That's just indicative of who can raise capital these days. The entire hedge fund industry has gotten much more institutional. As a result, minimums have gone up. I do not know if the same manager with the same investor profile starting out now would have a different minimum, but statistically the minimums seem to have gone up because of that change in investor profile."

Sklar further explained that the current investment climate has been influenced by several factors. "One clearly is Madoff. The high net worth individual market became nervous. Second, there is a long-term trend towards institutions realizing the value of alternative investments. So, while in the 'old days,' universities and unions or state pension plans might have been skittish about investing in hedge funds, they generally are not anymore." This can be attributed in part to the underfunding of pension funds, which requires such funds to seek out more attractive returns from alternative investment funds. See "Why and How Do Corporate and Government Pension Plans, Endowments and Foundations Invest in Hedge Funds?," Hedge Fund Law Report, Vol. 6, No. 14 (Apr. 4, 2013); "Credit Suisse Survey Reveals Allocation Preferences of Hedge Fund Investors, With Particular Attention on Preferences of Pension Funds and Insurance Companies," Hedge Fund Law Report, Vol. 6, No. 11 (Mar. 14, 2013).

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Additionally, in recent years, managers generally have adopted a more customized and flexible approach to setting fund terms, including minimum subscription amounts. According to Eisenberg, “Managers and their advisors tend to look at funds more organically than they did in the past. If you go back a number of years, there was more of a cookie cutter approach to funds for lock-up periods, minimum subscription amounts, fees and liquidity. Now, generally speaking, managers in the private fund space are, in consultation with their advisors, more commonly taking a customized approach to fund terms.” Eisenberg noted that rather than replicating what everyone else is doing, fund managers are also asking themselves, “‘What makes sense in the context of the facts and circumstances that apply to us – the strategy, the types of investors we are looking to attract, what investors would expect and need regarding fund terms and how can we effectively market to them?’ Minimum subscription amounts play into the overall analysis. There is less of a one-size-fits-all approach than in the past.” This is because, Eisenberg concluded, “There are more customized products. Institutional investors, which increasingly drive the business in terms of product types and product terms, are looking at managers in ways that tend to be more about what makes sense given a manager’s product. If, for instance, a manager just decides to blindly follow the pack, smart investors are asking, ‘Why did you do it this way? Why are you asking for this term?’ So, part of it is that investors and marketers are kicking the tires, and so the managers are trying to put in place a product that is going to, on the one hand, work from an investment strategy execution and administrative standpoint, but also be attractive to investors. That leads to a willingness to look at all the different building blocks of a fund, including potentially minimum subscription amounts, to see what makes sense.” For more on the trend towards customization of hedge fund products for investors, see “Infovest21 Survey Reveals Hedge Fund Manager Perspectives on Top Concerns, Business Changes, Staffing, Investor Allocations, Fund Terms, Fees and Portfolio Composition,” Hedge Fund Law Report, Vol. 6, No. 17 (Apr. 25, 2013).

Fund AUM

Generally speaking, minimum subscription amounts are positively correlated with a fund’s AUM. Murtha explained, “Smaller funds that have less than $150 million under management – where you are talking about advisers who are not registered – generally have minimums of $100,000 or $200,000. The funds that have the $5 million minimums are the funds that have billions under management. They are part of complexes, and are very unusual. For managers who are just starting out with a first fund, they are usually less than $1 million unless they are very well connected.” Domina further explained, “Oftentimes, the $100 million mark is used as one of the significant milestones as to moving a fund from one category to another category and potentially helping it to attract more institutional investors who may be more interested in it because generally it’s at least now at a level of critical mass by getting to $100 million. For other institutional investors, that number may be larger, it might be $250 million or $500 million.”

Minimums Applying at the Manager Level or the Fund Level

Minimum subscription amounts generally apply at the fund level, and typically, the requirement may not be satisfied by the investor’s investment across multiple funds operated by the same manager. Murtha noted, “Most of the time, they apply at the fund level, but there are cases where they can apply at the manager level. For example, where you have something like a Delaware LLC with segregated series, which are all managed by the manager, but each of the

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series has a different strategy, and the documentation basically says that you can come into this LLC structure and you have an overall minimum of investment of $500,000. However, the investor can put 25% of this minimum in Fund Series A, and 30% in Fund Series B, and 45 % in Fund Series C, and the investor can change these allocations if it wants." See "Understanding the Benefits and Uses of Series LLCs for Hedge Fund Managers," Hedge Fund Law Report, Vol. 5, No. 43 (Nov. 15, 2013). Sklar added, "Sometimes, side letters (which often have a customized, higher minimum), will say that for minimum investment purposes, count all investments in affiliated funds. If it's silent, then the minimum applies to each investment and the manager will decide if he/she wants to waive it because the investor already has the minimum in the first fund, but the manager's standard documents typically do not provide for any aggregation. Certainly, you are going to be more tolerant of someone who had already given you $1 million and wants to put $200,000 in your other fund. You are more likely to say yes."

Aggregation Over Time or by a Group of Investors to Meet the Minimum Subscription Amount Requirement

Managers do not typically permit an aggregation of investments over time to meet the minimum subscription amount requirement. Sklar observed, "That's fairly uncommon. It really gets down to the same waiver issues you'd normally have. If you think the person would be a good client and you need the capital, you might waive the minimum. You normally wouldn't take seriously a 'promise' that in a year or two the investor would come up with the rest of it because you do not know if the commitment is real." Gordon agreed, noting, "Hedge fund investing is an investment decision at the time of the investment, it's not like you are paying for law school or college where you contribute a little at a time. It's an investment decision, so I haven't seen that. Usually, the manager just waives it."

It is also uncommon for managers to permit a group of investors to aggregate their investments to meet the minimum subscription amount requirement. There are some instances, however, where it might take place. Murtha noted, "If it's three guys, then probably not. Then the thing to do would be to waive it for those people or not accept them at all or whatever the manager wants to do. More frequently, what would be the case is that you have a group of investors, but the actual investment decision is coming from a single source. So, either you have a person who is investing for their own account, and for an account for which they are the trustee for a grandchild. So, it's several accounts that they are managing, and they are combining that – pulling that together to make an investment. Alternatively, it's somebody's own account and their IRA, or an account of two funds (a U.S. fund and an offshore fund), and the investment decision is still being made by the same person. You would want to have something in writing saying that this is what we have agreed to." Sklar added, "It happens in the sense of some consultants or platforms, and they say that a certain group of clients will count together. That happens. But usually, it's through a single portal."

Follow-On Investments

Minimum subscription amounts typically apply not only to initial investments, but also to follow-on investments in a fund by an investor, although often at lower levels. As Domina explained, "They are usually round numbers so that you do not have people sending in odd lot additional subscriptions. The additional subscription amounts are generally lower than the initial minimum subscription amounts, to encourage additional subscriptions. The lower additional subscription

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amounts are intended to be an incentive for the existing investor to put more money in, in a way that is more incremental and not where they feel like they have to meet the initial minimum subscription amount every time they put more money in." Gordon noted that minimums are required for additional investment amounts "for administrative reasons. You do not want investors to be contributing $10,000 at a time. Then you become, especially if you have a large number of investors, like a cash machine, and it becomes administratively inconvenient." Sklar pointed out, however, that while usually the initial minimum subscription amount and the additional minimum subscription amount requirement both are typically included in the fund offering documents, "many funds are also silent as to minimums on additional investments."

Eisenberg confirmed that the minimum requirement for additional subscriptions is typically lower than that for initial subscriptions. "Usually, it's a fraction; it sort of depends on the size of the initial minimum. If you see a minimum initial subscription amount of $1 million, it would be fairly common to see minimum additional subscription amounts of $100,000 or $250,000. However, it really varies. It becomes a question of what makes sense from the standpoint of the manager, and also other factors come into play as far as the ability to put the money to work – the administrative costs, etc. But usually, it's going to be something like one-fourth, one-tenth, or some other fraction of the minimum initial subscription amount. That's just the convention; it does not have to work that way."

Redemptions Below the Minimum Subscription Amount

Hedge fund managers typically will not permit redemptions that cause the investor's total investment in a fund to fall below the minimum initial subscription amount. Murtha stated, "Managers typically have a minimum holding, and frequently, that is the same as the minimum subscription amount. But sometimes it's lower. Sometimes, for example, the minimum investment will be $1 million, and the minimum holding will be $100,000. The idea behind having a minimum holding is it's a way of enforcing the minimum. Let's say I had my minimum investment set at $1 million and I had my minimum holding at $1 million, that prevents my investor from subscribing with $1 million, and then on the next redemption date, going and redeeming $800,000 of it."

Sklar added, "It's fairly common for offering documents to provide that the manager may treat a partial redemption as having the same effect as a full redemption. If the investor is a difficult investor – not a particularly loyal investor – then the manager might well exercise that right to return the remaining capital. But, if it's an investor who you wish to keep, then you might as well let the investor keep the balance of the capital in and continue to have the investor receiving your reports and hope that the money comes back. It depends on your relationship with the investor." See "Mandatory Redemptions Enable Hedge Fund Managers to Control Regulatory and Reputational Risks, Contain Costs and Accommodate Maturation of Investor Base," Hedge Fund Law Report, Vol. 3, No. 17 (Apr. 30, 2010).

Waivers of Minimum Subscription Amounts

While hedge fund managers generally reserve the right in fund documents to waive minimum subscription amounts without investor consent, they typically do not do so on a regular basis, other than for friends, family and knowledgeable employees. As Murtha pointed out, "Exceptions generally can be made. However, managers generally do not want to make them. Managers like money. They are always trying to get as much money from an investor as they can. Managers

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are willing to negotiate and generally go out of their way to meet demands of potential investors so that they can bring the money in, but generally they are not willing to go out of their way so that they can bring less money in. That's just not where the focus is. If they are going to be amenable to change terms, it's generally for larger investors who are not going to be so concerned with the minimum subscription amount. That said, for friends, family and employees, that stuff happens all the time, and there are some managers who are just cash-starved, and they are willing to waive things."

Of course, in order to effectuate a waiver, the manager must reserve for itself the authority to waive any minimum subscription amounts and disclose such authority in the fund offering documents. Eisenberg observed, "The way the fund documents are set up is that the waiver can be made without having to get investor consent or provide notice to other investors. However, these days, institutional investors with their extensive pre- and post-investment due diligence and reporting requirements may require notification if waivers are issued by the manager. So, it's something that could be disclosable. An offering document which describes a minimum subscription amount is subject to antifraud provisions of the securities laws, and so, if a manager does not plan on enforcing it ever, there's a question as to whether there should be a different (i.e., lower) disclosed minimum subscription amount – because a manager does not want to include something in the offering document that is not going to be materially accurate." See "FRA Conference Juxtaposes Manager and Investor Perspectives on Hedge Fund Due Diligence (Part Two of Two)," Hedge Fund Law Report, Vol. 6, No. 23 (Jun. 6, 2013).

Moreover, if an investor asks for a substantial waiver of the minimum subscription amount, it could also indicate that the investor is not, in fact, qualified to invest in the fund. For example, Domina commented, "If you have a minimum subscription amount that is $1 million and all your investors are qualified purchasers, but if there is a particular qualified purchaser that is asking you to waive that to a substantial degree, that may lead you to question whether the investor is, in fact, a qualified purchaser."

Waiving the minimum subscription amount requirement for an investor typically does not raise fiduciary duty concerns, Murtha explained. "Every manager enters into side letters, and some are more objectionable than others, and the waiver of a minimum subscription amount is really not giving one investor an advantage over another." Sklar agreed. "The great majority of funds give the managers flexibility on minimums," he said, "and I do not see any fiduciary problem with doing that or with the manager's exercising of that right. It usually does not matter to one investor how much another investor is required to put in." See "Can Hedge Fund Managers Contract Out Of Default Fiduciary Duties When Drafting Delaware Hedge Fund and Management Company Documents?," Hedge Fund Law Report, Vol. 6, No. 14 (Apr. 4, 2013).

Eisenberg elaborated, "Assuming that it's not prohibited or the waiver does not allow someone to come in that is, for instance, in contravention of the minimum required by Cayman law, in terms of fiduciary responsibilities, I'd say that this would not violate the manager's fiduciary duty, not in terms of minimum subscription amounts as compared to other waivers, as a waiver of a minimum subscription amount will not usually have a material adverse impact on other investors or the fund. Of course, if the manager has agreed to a most favored nation [MFN] provision or has signed a representation letter or certification to the effect that all investors are coming in on exactly the same terms and no exceptions have been made, then there may be a notice requirement, or the manager may be required to take other actions as delineated in the MFN provision, representation letter or certification. A manager should look at its side letters. It should look at whatever letter agreements it has with investors. Prior to granting a waiver or preferred term, a manager should consider whether it will be, or is likely to have, a material adverse impact on other investors or the fund as a whole. If yes, then that may be a reason to

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reconsider or not to move forward with the waiver or preferential term. But if the manager, in consultation with its advisors, can get comfortable that a material adverse impact, breach of MFN provision, representation letter or certification will not arise as a result of waiving the subscription amount, then the manager should be able to proceed." See "Eight Recommendations for Hedge Fund Managers That Utilize Most Favored Nation Provisions in Side Letters," Hedge Fund Law Report, Vol. 5, No. 22 (May 31, 2012).

Knowledgeable employees are often granted waivers from the minimum subscription amount requirements and are encouraged to invest in their employer's funds. See "Are the General Counsel and Chief Compliance Officer of a Hedge Fund Manager Considered 'Knowledgeable Employees' of the Manager?" Hedge Fund Law Report, Vol. 5, No. 35 (Sep. 13, 2012). Gordon explained that knowledgeable employees are "Typically more sophisticated investors. In fact, they are often asked to contribute a substantial portion of their earnings into their fund to, so to speak, put their money where their mouth is. Therefore, the minimum subscription amount may not even be relevant to many of them."

MFN Provisions

Implicit in some of the foregoing discussion is the question of whether the holder of MFN rights (often granted through side letters) has the right to receive the benefit of any waiver or reduction in any minimum additional subscription amounts granted to another investor. On some of the challenges in connection with administering MFN provisions, see "Sixth Annual Hedge Fund General Counsel Summit Highlights SEC Enforcement Priorities, Side Letters, Investment Allocations, Expense Allocations, Trade Errors, Record Retention, Fund Marketing, Secondaries, JOBS Act and STOCK Act (Part One of Two)," Hedge Fund Law Report, Vol. 5, No. 39 (Oct. 11, 2012). Sklar commented, "It depends on the exact language of the side letter. It's usually not what the side letter contemplates, but it could certainly be triggered. It should be drafted around if that's not the intention. It gets complicated because of the difference between granting an investor a right going forward as opposed to waiving a restriction in a particular instance. So, when someone gets the most favored nation right, they are not necessarily expecting to get whatever waivers the manager ever gives. The one-time waiver should be thought of as different from changes to the terms of the investment. The person who has the most favored nation right ordinarily is not expecting to get every waiver that ever occurred because a waiver is a one-time thing. An investor may get a one-time reduction in the minimum, but then, the next month, it's back in force."

Side Letter Rights

Agreeing to a higher minimum subscription amount can be a powerful tool for investors in negotiating important rights through side letters, such as reduced fees or better liquidity terms. Gordon noted, "You are looking at what the SEC would like you to have – equal treatment of all investors. But, typically, if you are investing a lot of money, you want the same treatment as any other investor who had invested the same amount of money. You would want to receive more transparency (maybe certain rights only applicable to you) and try to get more redemptions or fee waivers. Often fee waivers are tied to a large amount of assets under management, which makes sense. If you are investing a lot more money, presumably it's easier to manage; it's often easier to manage more money than less money (i.e., in terms of having to manage interactions with multiple investors)." See "Preqin Study Reveals Institutional Investors' Latest Views and Expectations on Hedge Fund Terms," Hedge Fund Law Report, Vol. 5, No. 36 (Sep. 20, 2012).

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Eisenberg agreed, and added, "Certainly, when you have a strategic seed investor or other strategic investor come into a fund, subject to that investor investing and possibly maintaining with the manager for a period of time a minimum amount, the manager may be more willing to offer concessions, more favorable terms by way of a side letter or letter agreement. Such more favorable terms may vary, but the types of more favorable terms that are common include preferred fee terms (i.e., lower fee rates, clawbacks, etc.), MFNs, increased transparency and reporting undertakings, and sometimes liquidity as well, although in a fund that can create legal and fiduciary issues. But yes, it is common for this type of investor to initially request, or insist upon, certain preferred terms. And a manager may be more willing to agree to these terms if a significant initial amount of money is invested, above and beyond what might be the standard fund minimum." See "Are Side Letters Granting Preferential Transparency and Liquidity Terms to One Investor Ipso Facto Illegal?," Hedge Fund Law Report, Vol. 4, No. 18 (Jun. 1, 2011). For more on seeding arrangements, see "Seeding, Strategic Stakes and the Evolving Market for Third-Party Investments in Hedge Fund Management Businesses," Hedge Fund Law Report, Vol. 6, No. 20 (May 16, 2013).

Sklar specified, "Minimums often come into play in terms of liquidity rights. If you agree to a higher minimum, you might get better liquidity in the bigger funds that have more interesting structures. You might, for example, get a 'soft lock-up' (i.e., a right to withdraw prior to the end of a lock-up period, typically one year, subject to a withdrawal charge), instead of a 'hard lock-up' (an absolute prohibition on withdrawal during the lock-up period), or a quarterly instead of an annual withdrawal right. Some funds have three-year rolling lock-ups, but a large investment may reduce that to one year. That's really where the minimums come in. And fees also. You might put in more money and get lower fees too. So for those funds with classes of investors, those minimums become very important." See "Soft Lock-Ups Help Hedge Fund Managers Reconcile the Goals of Stable Capital and Investor Liquidity," Hedge Fund Law Report, Vol. 3, No. 45 (Nov. 19, 2010).

What is at stake in the side letter negotiation, however, is not just what benefits a manager can confer upon the investors. Eisenberg pointed out, "In those situations, it's important that the manager really understand that it's a two-way street, or it should be a two-way street. The manager is giving benefits and preferred rights to an investor. So the manager needs to make sure that it understands the extent of the commitment from the investor. How much money is the investor contributing? Are there any outs or exceptions or limitations on that? How long if at all is the investor required to maintain those assets with the manager? Are there any accelerated liquidation rights that would allow the investor to get out earlier and what are those circumstances? The manager needs to understand, before it actually agrees to these preferred terms, the value and the benefit that it's getting from the commitment in terms of dollars from the investor."

Modifying Minimum Subscription Amounts

A question often arises in practice as to whether managers may lower or raise the minimum subscription amount and, if so, whether investor consent is required for either modification.

Lowering the Minimum Subscription Amount Requirement

As a preliminary matter, Domina noted that it would be highly unusual for a manager to seek to lower the minimum subscription amount for a fund in the fund governing documents. "I do not know if that's the typical case because normally the manager would deal with the waivers on a

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case-by-case basis and would likely want to keep the minimum subscription amount on the offering document higher even if he's making exceptions because that's potentially a better posture to the marketplace rather than going back to the market and lowering the minimum subscription amount because then the question would be, 'Why are you lowering your minimum subscription amount?' That might look like a sign of the manager's inability to raise capital or that he does not have sufficient institutional interest, or that the manager has decided to target a more retail and less institutional investor base. So, I cannot think of an example where a manager has done that, although of course, it's possible, and I'm sure there are some managers out there who have done it."

In the rare case the manager wishes to adjust the minimum subscription amount down, doing so typically does not require the consent of investors. However, the manager must ultimately look to its fund governing documents to make the determination as to whether investor consent is required. Gordon explained, "It depends what is in your partnership agreement. Typically such requirements are not found in the partnership agreement. So I think you'd require a notification of the existing investors, but the managers still have the ability to waive, and if they do not want to notify (e.g., because of the message it would send to investors), they may not lower the limits, and do a waiver instead (if at all possible). A waiver certainly does not require consent of the investors. So, I think if the investment minimums are lowered, managers should notify investors and would probably want to attract more investments." Domina added, "if the manager needed to do it for whatever reason, then you would look to the offering document and the governing document like the limited liability company agreement or the limited partnership agreement to look at the ability of the manager to make those changes and what would be necessary to affect those changes. So, if the governing documents give the manager the ability to do so, the manager could make the change to the offering documents to lower the minimum investment amount and send a revised PPM to investors. Presuming the governing documents allow the manager to do a negative consent, that would be potentially sufficient. You would also look at whether the change would be viewed as material – as having a material adverse effect on other investors. So, you would look at the specifics of what the manager wanted to do; what the potential effect of it was; and what the manager's ability is in the fund documents, especially in the governing documents like the limited liability company or limited partnership agreement or the memorandum and articles, in order to see what power the manager has and how they could affect a change like this. If the manager came to that conclusion, he would revise it in the books and send it out to investors."

Raising Minimum Subscription Amounts

It is also not common for a hedge fund manager to seek to raise the minimum subscription amount in fund governing documents. As Gordon noted, "It happens more de facto if you have a 3(c)(1) fund converting to a 3(c)(7) fund, for example, as you cannot exempt your current investors from Section 3(c)(7) regulatory requirements even though they have already invested. To address this potential issue, funds typically have the ability to kick investors out of a fund. In addition, it's important to build in the ability to convert to a 3(c)(7) fund from a 3(c)(1) fund or to increase investment minimums in your original documents to put investors on notice. In that way, on a going forward basis, you can raise the limit or convert without asking for consents.

In considering whether a manager has the authority to raise minimum subscription amounts without investor consent, Gordon commented, "In general, I do not think you need consent to simply raise the limits. I think you should treat your existing investors politely and potentially apply the new limits to new investors only (or also new investments by existing investors only if you are considering closing your fund or otherwise have a limited number of spots left)." See

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"Legal and Investment Considerations in Connection with Closing Hedge Funds to New Investors or Investments," Hedge Fund Law Report, Vol. 3, No. 37 (Sep. 24, 2010).

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