506(c) Funds & Rolling Funds

TL;DR

506(c) Funds, including "rolling funds," are innovative fund models that enable managers to publicly fundraise and therefore lower the barriers to entry for emerging fund managers.

What is Rule 506(c)?

The Jumpstart Our Business Startups (JOBS) Act of 2012 aimed to create jobs by allowing small and mid-sized businesses to crowdfund their capital needs. One of the rule changes of the JOBS Act split Rule 506 of Regulation D into two exemptions: Rule 506(b) and Rule 506(c).

Rule 506(b) closely follows the existing rule already in place.

- Does *not* allow general solicitation (aka public fundraising)
- Does allow up to 35 nonaccredited investors

Rule 506(c) reduced fundraising barriers for fund managers but increased barriers for nonaccredited LPs.

- Does allow general solicitation (aka public fundraising)
- Does *not* allow nonaccredited investors
- Funds can raise an unlimited amount of money provided that the fund takes reasonable steps to verify the accredited investor status of each investor

What is a 506(c) Fund vs. Rolling Fund?

Relaxed regulations, including Rule 506(c), and improving technology are driving investment vehicle innovation in the alternatives space and a rise in first-time fund managers. In 2020, venture investment platform AngelList launched Rolling Funds as a new product for fund managers that leverages Rule 506(c). Since inception, more than 70 Rolling Funds have publicly launched on AngelList.

Traditional commingled blindpool funds that follow Rule 506(b) prohibit fund managers from publicly fundraising. However, a 506(c) Fund allows fund managers to publicly fundraise from accredited investors.

A Rolling Fund is a type of 506(c) Fund that allows managers to publicly fundraise from accredited investors on a quarterly subscription basis. A Rolling Fund is structured as a consecutive series of limited partnerships under a master entity: at the end of each quarterly investment period, a new fund is offered on substantially the same terms, for as long as the Rolling Fund continues to operate. Fund managers can continuously accept new LP capital in the form of subscription-based quarterly commitments.

Fund Criteria

When is this fund model a ***good*** fit for fund managers?

Rolling Funds are an innovative fund product that can serve as a launching pad for emerging VCs deploying traditional equity products like SAFEs and convertible notes. This product can accelerate fundraising and building a track record for fund managers with its public marketing feature, and offer lower upfront and operating fund costs.

However, they currently do not work well with funds deploying innovative capital products, such as revenue-based loans and redeemable equity. These capital products generate additional legal, reporting, and other back office costs for fund administration platforms exclusively focused on VC funds.

Fund managers do not need to follow the more popular subscription model for Rolling Funds. RareBreed Ventures, led by Mac Conwell, launched a $10M 506(c) fund to publicly solicit capital targeted toward his 50K+ Twitter followers, but he did not implement the subscription model. The Calm Company Fund, led by Tyler Tringas, built its own quarterly subscription product rather than use AngelList to launch a second fund.

Benefits vs. Costs

Benefits

Fundraising / Democratizes Fundraising Process for Micro VCs: Fund managers can accelerate their fundraising process with Rolling Funds because they are allowed to generally solicit or publicly market their fund during fundraising, unlike the traditional 506(b) VC fund structure. More pre-seed and seed-stage fund managers have started to launch and raise Rolling Funds by leveraging their personal brands and networks on Twitter and other social media platforms. They can access a larger and more engaged audience remotely for free instead of navigating the ambiguous institutional LP world in person. They can also raise smaller checks from a larger number of LPs—up to 2K Qualified Purchasers (QP) and 100 non-QP, accredited investors—across multiple funds, than traditional VC funds, with up to 100 accredited investors.

Fundraising / Improves Access to Alternatives & Predictability for Smaller LPs: Rolling Funds typically have smaller minimum LP commitment sizes of $10K to $25K per quarter compared to $1M+ for traditional VC funds. This flexible fund structure can be more inclusive for smaller LPs writing smaller checks that do not meet the traditional fund criteria. LPs typically need to commit at least $5K to $25K per quarter for up to four quarters, and they have the optionality to adjust their quarterly commitment size over time. LP capital calls are more predictable than the longer-term, chunky nature of capital calls for institutional funds.

Investment Strategy / Build a Track Record Faster: Rolling Funds can help first-time fund managers build a track record faster than the traditional fundraising path. They can raise a smaller amount of capital than a traditional fund and start investing in companies immediately instead of waiting months or years to hold a meaningful first close.

Fund Service Providers / Frictionless and Lower Costs: Rolling Funds can be cheaper for first-time fund managers than raising a traditional VC fund or a series of SPVs on a deal-by-deal basis. AngelList charges an admin fee for the life of each quarterly vehicle that is 0.15% of LP contributed capital, with a $20K quarterly minimum fee, for a standard 10-year term. After the first two quarters, when the minimum is waived, fund managers will pay the $20K minimum fee until they raise $1.33M per quarter. For example, fund managers raising $1M or less annually will pay at least 4.75% of contributed capital in the first year and at least 8% in the following years. Fund managers should consider targeting at least $250K per quarter; otherwise, AngelList's admin fees will start to take over their investable capital and/or management fee.

Costs

Investment Strategy / Complex Portfolio Construction for GPs & LPs: The recurring nature of Rolling Funds makes it more difficult for GPs to execute on a portfolio construction approach. Volatile LP subscriptions limit the ability of fund managers to forecast the amount of investable capital in a quarter, which leads to ramping up their investment pace or passing on great deals in certain quarters. Rolling Funds provide flexibility and optionality for LPs, but LPs only participate in new deals made in that quarter for each fund. Later LPs that did not commit to earlier quarterly funds will not have exposure to those portfolio companies unless the GP makes a follow-on investment at a likely higher valuation than early LPs.

Fundraising / Limited Downstream Scalability: Rolling Funds can work well for smaller pilot funds targeting between $5M and $25M, but it is hard to pivot out of a Rolling Fund to accept larger institutional LP checks. The smaller fund sizes drive down the average check size and typically force fund managers to focus on investing at the pre-seed and seed-stage. Fund managers focused on the Series A round or later will have a difficult experience raising larger Rolling Funds and most likely will need to pursue the traditional fundraising path.

Legal / Auditing & Infrastructure Costs: The recurring nature of Rolling Funds increases the number of vehicles managed by fund managers and auditing costs. Rolling Funds create a new vehicle and K-1 tax form every quarter. Additionally, all LPs must be accredited investors, and the GP must take additional steps not required for traditional 506(b) funds to confirm that LPs are accredited. The more rigorous LP verification and onboarding process requires strong infrastructure to mitigate regulatory and friction issues, but AngelList is starting to solve this problem for VCs.

Legal / Need to be an Accredited Investor: Fund managers need to be an accredited investor to launch a Rolling Fund. This creates another barrier to entry for aspiring investors from underrepresented groups who bring a strong brand and founders want on their cap tables but lack the accredited investor status.

Fund Service Providers / Limited Ability to Support Alternatives to VC: AngelList is the leading platform to support back office services—including fund administration, tax, accounting, and reporting—for Rolling Funds deploying venture investments such as SAFEs, convertible notes, and priced equity. Outside of traditional VC, AngelList cannot handle alternative investment structures, including revenue-based loans and redeemable equity, that require more back office complexity.

Fund Pricing & Terms

What do 506(c) Funds and Rolling Funds typically charge LPs?

Subscription Amount: $1K - $25K per quarter

Subscription Period: 1-16 quarters

Management Fee: 2% of committed capital

Administrative Fee: 0.15% of committed capital, subject to a $20K minimum flat fee

Carried Interest: 20-30% based on an LP's subscription period. The subscription period is the number of quarters to which an LP subscribes in advance. LPs will pay carry only after receiving back 100% of their investment in the fund over their subscription period. Fund managers will not share any carry with AngelList for their own LPs, but they will share 5% carry with AngelList for LPs sourced on its platform.

Preferred Return: None

What are the other typical terms for 506(c) Funds and Rolling Funds?

Fund Size: $1M - $10M per year

GP Commitment: $1K - $25K per quarter

Investment Period: 5 years from final close

Fund Life: 10 years

	Traditional Funds	Rolling Funds
Earn management fees	✓	✓
Earn fund carry	✓	✓
Accept capital anytime		✓
Start deploying right away		✓
Auto-renewing capital		✓
Publicly fundraise		✓

Source: Angelist

AngelList Venture Pricing

Traditional Funds	Rolling Funds™	Syndicates
Admin fee: 1% of fund size	**Admin fee:** 0.15% annual of AUM	**One-time** $8k setup fee
✓ No carry on your own LPs	✓ No carry on your own LPs	✓ No carry on your own LPs
✓ 5% carry on AngelList LPs	✓ 5% carry on AngelList LPs	✓ 5% carry on AngelList LPs

Source: Angelist

FAQs

Does a Rolling Fund have to invest all its capital every quarter?

The short answer is no. If a fund does not invest all its capital in a given quarter, the remaining capital balance is automatically rolled into the next quarterly fund as additional capital from the fund's currently participating subscribers. LPs receive a corresponding contribution to the new quarterly fund in addition to their subscribed-for capital contribution.

How do Rolling Funds make distributions?

Distributions for Rolling Funds are similar to traditional 506(b) funds. Rolling Funds are structured as a series of limited partnerships, so subscribing LPs receive distributions, net of fees, from the quarterly funds in which they have invested.

What's the difference between Rolling Funds and Evergreen Funds?

An Evergreen Fund is a different kind of fund structure that marks-to-market or adjusts the value of its portfolio, typically every few years, and allows new LPs to invest during this funding window. However, this fund structure is unrelated to Rolling Funds.

What is an accredited investor?

An accredited investor means owning $1M in net assets, not counting primary residence, or at least $200K in annual income ($300K with a spouse). Recently, the SEC updated the accredited investor rule to include "knowledgeable employees" of a VC fund, and these employees are exempt from the 100 LP limitation.

What is carried interest?

Carried interest, or "carry," is the share of profits from a fund that is paid out to its fund manager as a performance fee. A fund administration platform like AngelList also charges carry as part of its fee structure for managing a fund's operations.

What is a limited partner?

A limited partner, or “LP,” is an investor who commits capital to a fund.

What is a general partner?

A general partner, or “GP,” leads the management of a fund, while LPs have no active role or day-to-day involvement. GPs charge both a management fee and carry for managing their fund.

Opportunities to Build & Improve

Regulatory: Rule 506(c) was a step in the right direction by the SEC, but many regulatory hurdles remain enforced today that need to be updated to level the playing field for GPs and LPs, including the accredited investor requirements.

Fund Service Providers: There is an opportunity for another fund administration platform to build another version of AngelList focused on revenue-based investing and other innovative capital products for fund managers.

More Reading & Listening

https://news.crunchbase.com/news/you-keep-hearing-about-rolling-funds-and-syndicates-heres-how-they-work/

https://minal.substack.com/p/will-rolling-funds-roll-over-the

https://s-h-l.notion.site/How-to-Raise-a-Rolling-Fund-99220e692e5e40598c2230e5c7e8dce7

https://calmfund.com/writing/for-investors-introducing-quarterly-subscriptions-to-the-calm-company-fund

https://www.linkedin.com/pulse/new-rules-equity-crowdfunding-2021-chris-harvey/?trk=public_profile_article_view

https://www.investor.gov/introduction-investing/investing-basics/glossary/rule-506-regulation-d

For more tools and resources, visit innovative.finance/resources.

506(c) Fund & Rolling Fund Case Study

RareBreed Founder & Managing Partner: Mac Conwell

Overview

McKeever "Mac" Conwell II, is the founder and managing partner of [RareBreed Ventures](#) (RareBreed), a pre-seed stage venture fund based in Baltimore, Maryland. Previously, he was a seed-stage fund manager at the Maryland Technology Development Corporation (TEDCO), software engineer, and two-time founder. RareBreed invests early in founders outside of the large tech ecosystem of Silicon Valley, New York, and Boston. With early meaningful cash upfront, wraparound services to increase capacity, and institutional knowledge, RareBreed aims to accelerate a company's growth at the earliest stages.

In September 2020, Mac left TEDCO to launch his first venture capital fund and structured it as a 506(c) fund. He primarily built his LP network from scratch by publicly marketing RareBreed on Twitter. In Q1 2022, he closed $10M for Fund I with the support of Alpaca VC, Carta, Insight Partners, Plexco Capital, and a number of individual LPs. He plans to launch his second fund at $75M+ later in 2022.

Why a 506(c) fund?

The 506(c) fund enabled Mac to more quickly launch and accelerate fundraising for his $10M pilot fund than he would have with the more traditional and expensive 506(b) fund. He leveraged his Twitter community—20K followers at launch and 75K in June 2022—as a catalyst to raise his fund with 80% of LP capital coming from Twitter connections. The 506(b) approach would have restricted his ability to publicly market his fund and deals and required larger upfront costs to pay for institutional fund service providers.

However, it was not an easy fundraising journey at all for Mac. During the first year, he had 1K+ meetings and upward of 25 meetings per day.

Investment Strategy

RareBreed is a pre-seed fund that invests in underrepresented founders outside of large tech ecosystems, earlier than everyone else. RareBreed takes a concentrated portfolio approach by writing checks from $50K to $250K as the first or one of the first investors.

Track Record

RareBreed Ventures Fund I (2021, $10M): RareBreed has invested in 28 portfolio companies and generated a 1.64x MOIC and 1.57 TVPI as of December 31, 2021.

Fund I diversity metrics:

- 64% have an underrepresented founder
- 75% are located outside major tech hubs
- 43% have a POC executive
- 32% have a female executive

Portfolio companies include:

Faubion (Boston) creates premium custom-made engagement rings.

Jefa (Mexico City) is a FinTech startup offering digital accounts designed for women living in Latin America.

Juno Medical (NYC) is a primary care company.

Minority Business Pre-Seed Fund at TEDCO (2016-20)

Mac was the fund manager of the Minority Business Pre-Seed Fund (MPBF), which is a VC fund created through a partnership between TEDCO and Harbor Bank Community Development Corporation to address the capital needs of minority entrepreneurs in Maryland. The MBPF program makes investments of up to $40K to help minority entrepreneurs take a technology-based idea or concept that represents a viable business opportunity and develop it into a product that can be tested with potential users.

Fund Structure & Fund Terms

Fund: RareBreed Ventures LP (Delaware LLC)

GP: Mac Conwell	**Fund Size:** $10M
Minimum LP Commitment: $10K	**Investment Period:** 5 years
Fund Life: 10 years	
Management Fee: 2% of committed capital	
Carried Interest: 20%	**Preferred Return:** None

Key Person: Mac Conwell