



K&L GATES

2017 BOSTON INVESTMENT MANAGEMENT CONFERENCE

Special Issues for Registered Closed-End, Tender Offer and Interval Funds

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OVERVIEW

- Interval and tender offer funds are continuously offered registered closed-end funds that provide periodic liquidity to investors
- Differentiated primarily by structure of repurchase offers
 - *Interval funds* – repurchase conducted pursuant to Rule 23c-3 under the 1940 Act
 - *Tender offer funds* – repurchase conducted pursuant to tender offers at the discretion of the fund's board pursuant to Rule 13e-4 under the 1934 Act

OVERVIEW (CONTINUED)

- Investor Interest
 - Interval and tender offer funds appeal to investors looking for the regulatory safeguards of a registered fund coupled with greater exposure to illiquid investments and potential for high yield (as compared to a mutual fund)
 - Prospective regulatory changes may encourage greater use of these products, particularly interval funds, due to proposed greater flexibility

OVERVIEW (CONTINUED)

- Like other closed-end funds, ability to invest in less liquid securities can provide access to financial instruments with higher yield than traditional mutual funds
- Offer subscriptions and periodic liquidity at NAV (exchange-listed funds trade at the price of the shares on the secondary market)
- Continuously offered, so fund size can grow over time (as compared to IPO)
- See Appendix for detailed comparison of interval and tender offer funds

INTERVAL FUNDS: KEY ADVANTAGES

- Treated like an open-end fund for purposes of share registration, with registration fees based on net sales
- No required FINRA filing fees, and subject only to Rule 2341 which imposes varying caps on sales compensation/distribution fee levels

TENDER OFFER FUNDS: KEY ADVANTAGES

- More flexibility in **timing** of repurchase offers
 - Contrast: Interval funds must conduct periodic repurchase offers every three, six, or twelve months; for tender offer funds, board has discretion
- More flexibility in **amount** of repurchase offers
 - Contrast: Interval funds' repurchase offer is restricted to an amount between 5-25%; for tender offer funds, board has discretion
- Not subject to portfolio liquidity requirements imposed on interval funds

INTERVAL FUNDS: CHALLENGES

- Subject to portfolio liquidity requirement during repurchase offer period:
 - During repurchase offer period, fund must hold assets equal to the repurchase offer amount
 - If the board chooses a low repurchase offer amount, the fund may need to accept tendered shares on a pro rata basis
 - Fund must have sufficient liquidity to cover these additional tendered shares
- Repurchase offer timing and amount restricted by rule
- Must establish fundamental policy of making periodic repurchase offers, changeable only by a majority vote of the fund's outstanding voting securities

TENDER OFFER FUNDS: CHALLENGES

- Requires initial registration of share offering amount and registration of any additional shares prior to sale (not automatically effective)
- Subject to certain FINRA filing requirements and Corporate Financing Rule (However, FINRA will consider individual requests for exemptions from lifetime caps on sales compensation/distribution fee levels)
- FINRA fees due for shares registered (unlike interval funds)

RECENT DEVELOPMENTS

- October 2017 Treasury Report encourages SEC to promulgate rules that will allow for greater investment in private companies by registered funds
- Intended to promote creation of registered closed-end funds that invest in offerings of smaller public companies and private companies whose shares have limited or no liquidity
- Treasury Report Recommendations:
 - SEC should review interval fund rules to determine whether more flexible provisions might encourage greater investment in illiquid securities
 - Rather than requiring periodic repurchase offers, SEC should consider allowing redemptions based on a liquidity event of an underlying holding
- Because new liquidity rule may push certain asset classes to be less liquid, managers are considering alternative CEF structures such as TO and Interval Funds

APPENDIX: INTERVAL FUNDS VS. TENDER OFFER FUNDS

	Interval Fund	Tender Offer Fund
Structure	Closed-end	Closed-end
Shares Offered	Continuously	Continuously
Share Pricing	No less frequently than weekly, but at least daily on the 5 business days preceding a repurchase request deadline.	Periodically
Share Registration	Treated like an open-end fund, with registration fees based on net sales.	Initial registration of share offering amount; thereafter must register additional shares <u>prior</u> to sale (not automatically effective) and pay filing fees.
Repurchase Procedures	Periodic self-tenders must comply with Rule 23c-3(b) of the 1940 Act.	Tender offers at the board's discretion must comply with the 1934 Act Section 14, Rule 13e-4, Schedule TO, and other procedures for conducting the issuer tender offers.
Required Policies	Interval funds must establish a fundamental policy of making periodic repurchase offers, changeable only by a majority vote of the outstanding voting securities of the fund, which must be disclosed in the fund's annual shareholder report.	Tender offer funds are not required to establish as a fundamental policy that the fund will make periodic repurchases.

APPENDIX: INTERVAL FUNDS VS. TENDER OFFER FUNDS (CONTINUED)

	Interval Fund	Tender Offer Fund
Initiation of Repurchase	The fund conducts periodic repurchase offers of 3, 6 or 12 months [depending upon the time period set in the fundamental repurchase policy at formation]. More frequent repurchases require an SEC exemption.	At the board's discretion, the fund may initiate a tender offer for its shares. The board must determine that making a tender offer is fair and would be in the best interests of the fund and its shareholders.
Discretionary Repurchases	In addition to periodic repurchases, an interval fund may make discretionary repurchase offers (not more frequently than once every two years) for any amount of the fund's outstanding shares.	All repurchases are discretionary because tender offers are only conducted subject to the board's discretion, but tender offers must be open to all holders of a class of security.
Offer Period	Shares are periodically repurchased pursuant to a schedule set forth in the fund's annual report. Holders of shares subject to the repurchase offer receive notification no less than 21 and no more than 42 days before each repurchase request deadline.	Unless withdrawn, the tender offer must remain open until the expiration of: (i) at least 20 business days from its commencement and (ii) at least 10 business days from the date that notice of an increase or decrease in the percentage of the class of securities* being sought, the consideration offered or the dealer's soliciting fee to be given is first published, sent or given to shareholders.

*At the close of the tender offer period, the fund can accept up to an additional 2% of the fund's assets without such amount being deemed an "increase" for purposes of Rule 13e-4.

APPENDIX: INTERVAL FUNDS VS. TENDER OFFER FUNDS (CONTINUED)

	Interval Fund	Tender Offer Fund
Repurchase Offer Amount	Each quarter (or other period if so set), the fund's board determines the percentage of the fund's shares that the fund would offer to repurchase – the amount must be between 5% and 25% of the fund's outstanding shares.	The amount of the tender offer is set by the fund's board.
Repurchase Price	<p>Shares must be repurchased for cash at the net asset value determined on the "repurchase pricing date," and payment must be made by the "repurchase payment deadline."</p> <p>The "repurchase pricing date" must occur no later than the 14th day after the deadline by which investors must submit a repurchase request.</p> <p>The "repurchase payment deadline" must occur seven days after the repurchase pricing date.</p>	All shareholders must be paid the highest price paid to any other holder of the same security per the "best-price rule." If more than one type of consideration is offered, then shareholders must be afforded equal right to elect among each type offered.

APPENDIX: INTERVAL FUNDS VS. TENDER OFFER FUNDS (CONTINUED)

	Interval Fund	Tender Offer Fund
Suspension of Repurchase	A periodic repurchase offer may be suspended only by vote of a majority of the fund's directors, including a majority of the "independent directors," and only under the limited circumstances specified in Rule 23c-3 (similar to those applicable to open-end funds, but also if the repurchase offer would cause the fund to lose its status under Subchapter M of the Internal Revenue Code of 1986, as amended (the "Code")).	The fund must either pay the consideration offered or return the tendered securities promptly after the termination or withdrawal of the tender offer.
Repurchase / Redemption Fee	Interval funds may establish and charge shareholders a repurchase fee, not to exceed two percent (2%) of the proceeds pursuant to Rule 23c-3(b)(1), that is reasonably intended to compensate the fund for its expenses.	An early repurchase fee may be charged as a percentage of the tendered amount.
Withdrawal of Tender	The fund must allow shareholders to withdraw tenders of shares for repurchase at any time prior to the repurchase request deadline.	The fund must allow shareholders to withdraw tenders of shares for repurchase at any time while the tender offer is open; and if not yet accepted for payment, after the expiration of 40 business days from the commencement of the tender offer.

APPENDIX: INTERVAL FUNDS VS. TENDER OFFER FUNDS (CONTINUED)

	Interval Fund	Tender Offer Fund
Oversubscribed Repurchase	<p>If offers for repurchase exceed the amount of repurchased shares authorized, the fund must accept repurchases <i>pro rata</i> under Rule 23c-3.</p> <p>If the board chooses a low repurchase offer amount (e.g., 5%), it is possible that the fund may need to accept tendered shares on a <i>pro rata</i> basis. Rule 23c-3 permits an interval fund to purchase an additional number of tendered shares, not to exceed 2% of the fund's outstanding shares, to avoid having to accept shares <i>pro rata</i>—although it is not required to do so. However, it is important to note that if the fund does avail itself of this 2% cushion the fund must have sufficient liquidity in its portfolio to cover these additional tendered shares.</p>	<p>If offers for repurchase exceed the amount of repurchased shares authorized, the fund can extend the offer or accept tendered interests on a <i>pro rata</i> basis.</p> <p>Shares accepted on a <i>pro rata</i> basis, provided that the fund may accept (i) all shares from a holder owning less than 100 shares and tendering all of their shares, before pro-rating shares tendered by others; or (ii) by lot shares tendered by a holder tendering all of their shares who elects to have either 'all or none' or 'at least a minimum amount or none' accepted so long as the fund first accepts all shares from holders who did not make such election.</p>
Borrowing	Any borrowing, including any borrowings to cover repurchases or any issuance by the fund of senior securities, must meet the asset coverage limitations of 300%, including the amounts borrowed.	Any borrowing, including any borrowings to cover repurchases or any issuance by the fund of senior securities, must meet the asset coverage limitations of 300%, including the amounts borrowed.

APPENDIX: INTERVAL FUNDS VS. TENDER OFFER FUNDS (CONTINUED)

	Interval Fund	Tender Offer Fund
Portfolio Liquidity Requirements	During the repurchase offer period, an interval fund must hold liquid assets equal to the amount of the shares offered for repurchase that can be sold or disposed of in the ordinary course of business at approximately the price at which the fund has valued them.	Not subject to the liquidity requirements imposed on interval funds.
Investor Liquidity	From periodic repurchase offers.	Exclusively from occasional tender offers.
Disclosure and Notification	Disclosure and notification requirements of Rule 23c-3 do not permit notification by publication in a newspaper (as is permitted for tender offer funds), so an actual mailing to interval fund shareholders each quarter (or other period set) is necessary. The fund must send to each holder of shares subject to the repurchase offer a notification providing certain required information no less than 21 and no more than 42 days before each repurchase request deadline.	Notification to shareholders of tender offers may be conducted through notification in a national (<i>i.e.</i> , The Wall Street Journal) and/or regional publication rather than direct notification mailings as required for interval funds.

APPENDIX: INTERVAL FUNDS VS. TENDER OFFER FUNDS (CONTINUED)

	Interval Fund	Tender Offer Fund
SEC Filings	File Form N-23c-3 and the notification regarding the repurchase sent to security holders within three business days after sending such notification.	File (i) all written communications made by the fund or an affiliate relating to the tender offer, from and including the first public announcement, as soon as practicable on the date of the communication and (ii) Schedule TO, including exhibits and all amendments thereto.
FINRA Requirements	Subject to Rule 2341, which imposes varying caps on sales compensation/distribution fee levels.	Subject to the FINRA Corporate Financing Rule, which imposes fixed lifetime caps on sales compensation/distribution fee levels. However, FINRA will consider individual requests for exemption from the requirements of the Corporate Financing Rule for such tender offer funds after a period of operation.
Distribution Fees	Calculation of brokers' compensation for the distribution of fund shares is regulated by Rule 2341, which regulates the distribution fee and sales charges of open-end funds.	Calculation of brokers' compensation for the distribution of fund shares is regulated by the fixed limitations on underwriting and distribution fee compensation in the Corporate Financing Rule.
Required FINRA Filing Fees	None.	Offerings of securities are subject to the filing requirements, an initial filing fee, and regulations of the Corporate Financing Rule.

APPENDIX: INTERVAL FUNDS VS. TENDER OFFER FUNDS (CONTINUED)

	Interval Fund	Tender Offer Fund
Not Exchange Listed	Interval fund and tender offer fund shares typically do not trade on the secondary markets, and thus are not listed on a securities exchange as most traditional closed-end funds are.	
Directors	A majority of the directors of both an interval fund and a tender offer fund must be directors who are not “interested persons” of the fund, and those directors must select and nominate any other disinterested directors.	
Legal Counsel	Rule 23c-3 requires that any person who acts as legal counsel for the disinterested directors be an “independent legal counsel.” However, there is no requirement for the independent directors to have such counsel.	



Questions?

