INTERVAL AND TENDER OFFER CLOSED-END FUNDS:

Investment Company Alternatives to Traditional Funds

2024 Update

CHAPMAN

Focused on Finance®

OVERVIEW

Fund sponsors are increasingly considering two similar types of registered closed-end investment companies known as "interval funds" and "tender offer funds" as an attractive alternative to open-end mutual funds, exchange-traded funds ("ETFs") and traditional closed-end funds. Interest in interval funds and tender offer funds has increased for a variety of reasons, including the Securities and Exchange Commission's (the "SEC") liquidity risk management program rule;[1] demand for asset classes that are not suitable for open-end funds, which must provide for daily redemption; and a weak market for traditional closed-end fund initial public offerings. More recently, interval and tender offer funds have served the role as a testing laboratory for new asset classes such as digital asset futures,[2] fine art,[3] and secondary market interests in private funds,[4] allowing regulators and asset managers alike the chance to observe strategies in a more controlled wrapper. At the same time, hedge fund and other private fund managers seeking to expand their pool of available investors have discovered that interval funds and tender offer funds may serve as vehicles for certain alternative investment strategies that would not be suitable in other registered investment company structures. Concerns regarding new compliance obligations for private funds and their managers and their related expenses may have shifted the economic calculus as to whether a private or registered fund wrapper is best for a particular investment strategy.

Interval funds are closed-end managed investment companies ("closed-end funds") registered under the Investment Company Act of 1940 (the "1940 Act") that rely on Rule 23c-3 under the 1940 Act to periodically offer to repurchase shares at their net asset value ("NAV") from shareholders[5] at predetermined intervals. Tender offer funds, on the other hand, are closed-end funds registered under the 1940 Act that conduct periodic tender offers on a discretionary basis pursuant to the applicable provisions of the Securities Exchange Act of 1934 (the "Exchange Act") and the rules thereunder. Unlike traditional closed-end funds that typically distribute their shares using an initial public offering, interval funds and tender offer funds continuously offer their shares at a price based on NAV.

This white paper provides a summary of the interval fund and tender offer fund structures, including their basic legal framework, their investment restrictions, how they are distributed and how they facilitate redemptions. It also provides a comparison of interval funds and tender offer funds, both to each other and to other types of investment companies. A table comparing the general characteristics of interval funds, closed-end funds and other types of investment vehicles is included as *Appendix I* to this document.

CONTENTS

BACKGROUND

Prior the adoption of Rule 23c-3, managed investment company sponsors were generally limited to two types of fund structures if they desired to sell the investment company securities to the public: open-end mutual funds and closed-end funds. Mutual funds allowed for the continuous offering of shares and provided daily liquidity to the funds' shareholders. However, the mutual fund requirement to hold a certain portion (generally fifteen percent) of a fund's portfolio in highly liquid investments restricted the types of investment strategies a fund manager could employ. Furthermore, the requirement to quickly satisfy redemption requests meant all of a fund's assets could not be invested at all times. Alternatively, traditional closed-end funds were not required to offer daily liquidity to investors, which permitted fund managers to engage in investment strategies involving less-liquid assets. However, as closed-end fund shares were generally exchange-traded, the shares would often trade at a discount to NAV. Closed-end funds whose shares traded at a discount to NAV for an extended period were generally restricted from issuing new shares due to the requirement that closed-end fund shares not be sold at a price below their NAV. Sponsors of such funds sometimes experienced difficulty launching new closed-end funds while shares of existing funds traded at a discount to NAV. More recently, such funds have become a target for activist shareholders seeking to cause funds to adopt a redemption program or liquidate, thus capturing arbitrage opportunities.

Wanting to bridge the extremes of the open-end mutual fund and closed-end fund structures, in the late 1980s some fund managers developed the first of what became known as tender offer funds.[6] These were closed-end funds that, instead of listing their shares on a securities exchange, made periodic, discretionary tender offers at NAV pursuant to Section 23(c)(2) of the 1940 Act. Shares of these funds were continuously offered to the public at NAV pursuant to Rule 415 under the Securities Act of 1933 (the "Securities Act"). In its 1992 report entitled *Protecting Investors: A Half Century of Investment Company Regulation*, the staff of the SEC recognized the innovations of tender offer funds that offered limited liquidity to investors. Shortly thereafter, the SEC proposed and adopted Rule 23c-3 in order to facilitate and provide additional flexibility to the periodic repurchase of shares by closed-end funds.[7]

While many managers welcomed Rule 23c-3 and structured new offerings as interval funds in reliance on the Rule, other managers sought additional flexibility in structuring their redemption programs. These managers launched closed-end funds that instead relied of the self tender offer provisions of the Exchange Act and the rules thereunder, specifically Rule 13e-4, that have become known as tender offer funds.

Since the introduction of Rule 23c-3, both interval funds and tender offer funds have grown in popularity. As of December 31, 2023, there were approximately 93 operational interval funds. While tender offer funds as a group are more difficult to define, as of December 31, 2023, approximately 89 active closed-end funds have made multiple issuer tender offers to common shareholders pursuant to Exchange Act Rule 13e-4, which represents a rough approximation of the tender offer fund market.[8]

INTERVAL FUND REPURCHASE OFFERS UNDER RULE 23c-3

Rule 23c-3 permits a closed-end fund or a business development company to repurchase its shares from shareholders at periodic intervals pursuant to repurchase offers made to all of the fund's shareholders. The following is a summary of how an interval fund may conduct repurchase offers pursuant to that rule.

Fundamental Policy

In order to operate as an interval fund, the fund must adopt a fundamental policy, changeable only by a majority vote of the outstanding voting securities of the company,[9] which policy must state:

- That the fund will make repurchase offers at periodic intervals;
- The periodic interval (*i.e.,* number of months) between repurchase request deadlines (as described below);
- The dates of repurchase request deadlines or the means of determining the repurchase request deadlines; and
- The maximum number of days between each repurchase request deadline and the next repurchase pricing date (as described below).

In addition, the fund's annual report must state this fundamental policy and the number, amount and results of any repurchase offers that occurred in the period covered by the annual report.[10]

Frequency

An interval fund may adopt either three, six or twelve months as the periodic interval between repurchase offers.[11] Some funds have secured exemptive relief from the SEC to conduct repurchase offers on a monthly basis, subject to certain conditions.[12] An interval fund is permitted to skip the repurchase that would otherwise occur at the first scheduled interval after the fund's registration statement is declared effective or after the fund's board of directors adopts a fundamental policy specifying the fund's periodic interval (*e.g.,* an interval fund that has adopted a policy to conduct a repurchase offer every six months may make its first repurchase offer in the twelfth month following the effectiveness of its registration statement).[13] In addition to its regularly scheduled repurchase offers, an interval fund may make one discretionary repurchase offer pursuant to Rule 23c-3 every two years.[14] Along with repurchases made pursuant to Rule 23c-3, an interval fund is permitted to conduct a tender offer pursuant to Exchange Act Rule 13e-4, as discussed below in connection with tender offer funds.

An interval fund may not suspend or postpone a repurchase offer except pursuant to a vote of the majority of the fund's directors, including a majority of the directors who are not interested persons of the fund, and only:

- If the repurchase offer would cause the fund to lose its status as a "regulated investment company" under Subchapter M of the Internal Revenue Code of 1986 (the "Code");
- If the repurchase would cause the fund's shares to be delisted (if applicable);
- For any period during which the New York Stock Exchange or any other market in which the securities owned by the fund are principally traded is closed (other than customary weekend and holiday closings) or during which trading in such market is restricted;

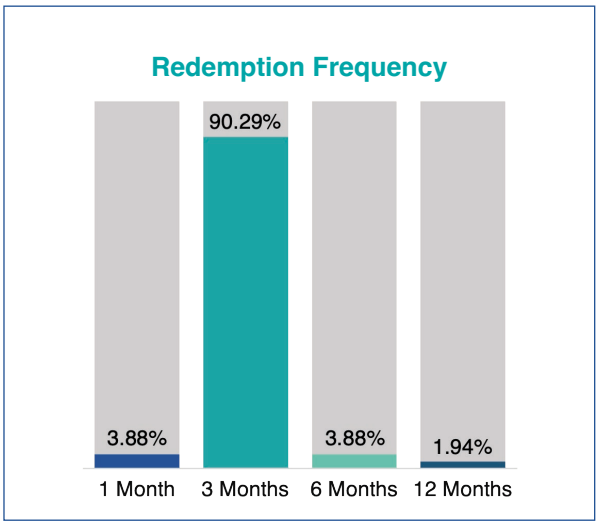
- For any period during which an emergency exists where disposal or valuation of the fund's securities is not reasonably practicable or during which it is not reasonably practicable for the company fairly to determine the value of its net assets; or
- For any period the SEC may order for the protection of the fund's security holders.[15]

An interval fund must provide notice to shareholders of any suspension or postponement of a repurchase offer.[16]

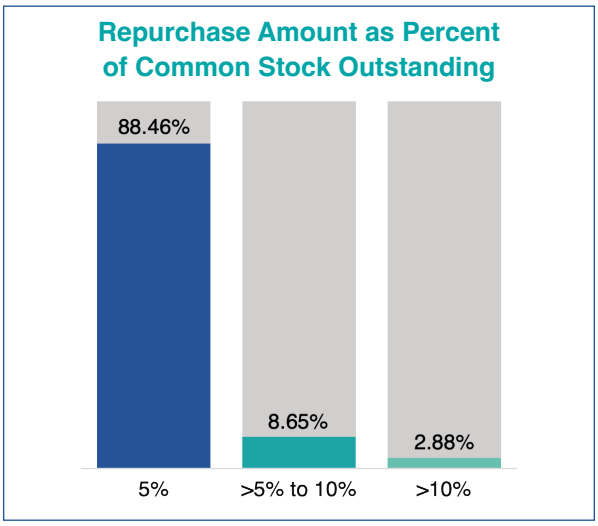
Repurchase Offer Amount

An interval fund must offer to repurchase between five and twenty-five percent of the fund's outstanding shares each periodic interval.[17] The specific amount must be approved by the fund's directors prior to commencement of the repurchase offer.[18] This provides interval funds with a great deal of flexibility is setting the terms of their repurchase polices—ranging from as little as five percent of outstanding shares once per year to as much as twenty-five percent of its outstanding shares four times per year (or more if the tender offer fund elects to conduct a discretionary repurchase offer or a tender offer pursuant to the Exchange Act). The repurchase offer amount may vary for each repurchase offer as determined by the directors of the fund.

The following charts show the percentage of interval funds that (1) have adopted policies to conduct periodic redemptions at the stated interval, and (2) have offered to redeem an amount of common stock equal to the state amount:



Based on disclosures in fund offering materials as of 6/30/2024.



Based on the most recent Form N-23c-3 and offering materials as of 6/30/2024.

If a fund's shareholders tender an amount of fund shares that exceeds the repurchase offer amount established by the fund's directors, the fund may repurchase an additional amount of shares not to exceed two percent of the fund's outstanding shares. In the event that the additional two percent is not enough to satisfy all tender requests, or if the fund chooses not to exercise its ability to increase the repurchase offer amount within the available limits, the fund must repurchase shares tendered on a pro rata basis. The fund is, however, allowed to (1) first accept all tenders by shareholders holding fewer than one hundred shares before prorating the shares tendered by others, or (2) accept by lot shares tendered by shareholders who tender all shares held by them and who have made an "all or none" or "minimum or none" election after first accepting all shares

tendered by shareholders who have not made such an election.[19] In practice, funds have generally used the former option. An interval fund may not condition a repurchase offer upon the tender of any minimum amount of shares.

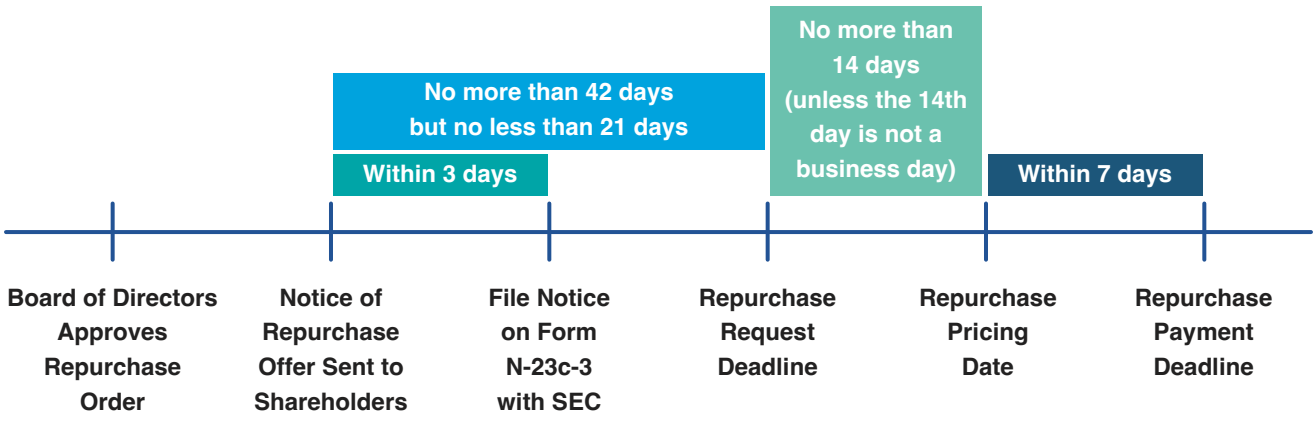
Timing

As discussed above, the interval fund's directors must first approve the repurchase offer amount before the corresponding repurchase offer is commenced. Once approval has been obtained, the fund must send notice of the repurchase offer to shareholders, which is described in additional detail below. The notice must specify the repurchase request deadline, which is the date by which the fund must receive repurchase requests submitted by shareholders in response to the repurchase offer.[20] It is also the date after which shareholders may not withdraw or modify their previously submitted repurchase requests. The repurchase request deadline must be no less than twenty-one and no more than forty-two days after the sending of the shareholder notice.[21] In addition, within three days of sending the notice to shareholders, the fund must file the notice with the SEC on Form N-23c-3.[22]

The repurchase pricing date is the date on which the fund determines the NAV applicable to the repurchase of securities. The repurchase pricing date must occur within fourteen days following the repurchase request deadline, or on the next business day if the fourteenth day is not a business day.[23] This fourteen-day period is intended to allow fund managers to assess their liquidity needs in order to satisfy repurchase requests.

The repurchase payment deadline is the date by which the fund must pay shareholders for any shares repurchased. The repurchase payment deadline must occur within seven days following the repurchase pricing date.[24] On such date, the fund must pay shareholders one hundred percent of the repurchase proceeds in cash (*i.e.,* no in-kind payments are permitted), less any redemption fee as discussed below.

The following graphic illustrates the temporal requirements of an interval fund redemption:



Shareholder Notice

The notice of repurchase must be sent to each shareholder of record and each beneficial owner of shares. The fund must then file that notice on Form N-23c-3 with the SEC. The notice must include the following information:

- A statement that the fund is offering to repurchase its securities from shareholders at NAV;
- Any fees applicable to the repurchase;
- The repurchase offer amount;
- The dates of the repurchase request deadline, repurchase pricing date and repurchase payment deadline;
- A statement of the risk of fluctuation in NAV between the repurchase request deadline and the repurchase pricing date;
- A statement that the fund may, under certain circumstances, advance the repurchase pricing date;
- The procedures for tendering shares and modifying or withdrawing previous tenders;
- A description of the procedures by which the fund may purchase shares on a pro rata basis;
- The circumstances in which the fund may suspend or postpone a repurchase offer;
- The NAV of the fund's shares computed no more than seven days before the date of the notice, and where shareholders may find the NAV following receipt of the notice; and
- If applicable, the market price of the fund's shares on the day the fund's NAV was calculated, and where shareholders may find the market price following receipt of the notice.[25]

Portfolio Liquidity During Repurchase Period

As discussed further below, from the time an interval fund sends the shareholders notice of the repurchase offer until the repurchase pricing date, the fund must hold highly liquid securities equal in value to one hundred percent of the repurchase offer amount.[26]

Redemption Fees

An interval fund may deduct from the repurchase proceeds a repurchase fee of up to two percent of the proceeds that are paid to the fund to reasonably compensate the fund for expenses directly related to the repurchase.[27]

TENDER OFFER FUND REPURCHASES

Unlike interval funds, tender offer funds rely on the Exchange Act tender offer provisions to conduct periodic, discretionary tender offers to investors pursuant to Section 23(c)(2) of the 1940 Act. Section 23(c)(2) permits a closed-end fund to conduct an issuer tender offer only after a reasonable opportunity to submit tenders is given to all shareholders of the class to be purchased. Instead of the redemption process set forth in Rule 23c-3, tender offer funds must comply with the requirements of Exchange Act Rule 13e-4. While this process is generally more burdensome than that allowed by Rule 23c-3, it does allow tender offer funds a higher degree of discretion and flexibility than is available to interval funds.

Tender Offer Amount and Frequency

Tender offer funds have wide latitude in establishing their share repurchase practices. Tender offer funds relying on Rule 13e-4 are not required to conduct a minimum number or frequency of tender offers—boards of directors are free to determine if and when their tender offer funds will conduct repurchases. Furthermore, the amount of the tender offer is left entirely to the discretion of the board. In the event more shares are tendered than the tender offer fund offered to buy, a tender offer fund may follow procedures for allocating repurchases that follow closely those prescribed for interval funds, as discussed above.[28] Despite this freedom, some tender offer funds do adopt policies to conduct regular tender offers of certain minimum amounts.

Given the wide variation among tender offer funds, there are no useful statistics regarding the amount of shares funds offer to repurchase at each tender offer. However, the majority of tender offer funds conduct quarterly repurchase offers, with a minority of funds making tender offers on a monthly, semiannual or annual basis.

Timing of the Tender Offer

Once a tender offer fund's board has determined to conduct a tender offer, it begins the process by filing Schedule TO with the SEC and providing notice to the fund's shareholders.[29] The fund must keep the tender offer open for at least twenty days from the date of the tender offer's commencement and at least ten days after certain changes to the amount of securities being repurchased or the consideration to be paid for the securities.[30]

Tender offer funds also have additional flexibility in the timing of payment of repurchase proceeds. Whereas interval funds are required to make payment within seven days after the repurchase pricing date, tender offer funds must make the payment "promptly" after the termination of a tender offer.[31] As discussed further below, this provides tender offer funds the ability to withhold a portion of redemption proceeds until a fund audit can be performed.

Required Filings

Tender offer funds commence their tender offers by filing Schedule TO with the SEC. Generally, the disclosure requirements of Schedule TO are more robust than those required of interval funds on Form N-23c-3. The Schedule TO disclosure requirements include the following:

- A summary term sheet;
- Certain information about the fund;
- The full terms of the tender offer, including, among other things, the amount to be repurchased, how long shareholders have to tender, any applicable redemption or other fees and how and when redemption proceeds will be paid;
- Disclosure of certain affiliated transactions in the past two years, significant corporate events in the past two years and any agreements involving the fund's securities;
- The purpose of the tender offer;
- The source and amount of the redemption proceeds;
- Disclosure of all advisers or solicitors engaged by the fund with respect to the tender offer; and

- Audited financial statements for the last two fiscal years, unaudited financial statements for the most recent fiscal quarter and certain other selected financial information.

The tender offer fund must also attach to the Schedule TO the various transaction documents, which typically include a letter to shareholders, an offer to purchase, the form of letter of transmittal, the form of letter of withdrawal, the form acceptance of tender letter and, if applicable, the form of promissory note.[32] Any Schedule TO may be subject to review by the SEC's staff, although the staff has generally been able to issue comments quickly given the relatively short period the tender offer may remain open.

FUND LIQUIDITY AND PORTFOLIO MANAGEMENT

During periods when there is no repurchase offer in effect, neither tender offer funds nor interval funds have restrictions with respect to portfolio liquidity. As discussed above, once an interval fund provides notice to shareholders of a repurchase offer, the fund is required to maintain one hundred percent of the repurchase offer amount in liquid assets (which may include a line of credit or similar instruments). Depending on the timing of the individual steps of the repurchase offer, an interval fund would be required to hold the repurchase offer amount in liquid assets for up to fifty-six days at every periodic interval. At the other extreme, an interval fund that conducted annual repurchase offers would have to maintain at least five percent of its portfolio in liquid assets for a minimum of twenty-one days every year.

Tender offer funds have considerably more flexibility with regard to portfolio liquidity. Even during the period while the tender offer is open, tender offer funds do not have any liquidity restrictions. As noted above, tender offer funds are required to pay redemption proceeds "promptly"; however, tender offer funds routinely delay payment of redemption proceeds in order to match the liquidity timeline of their underlying investments. For example, a tender offer fund holding a portfolio of privately offered hedge funds could pay redemption proceeds when received by the tender offer fund after the tender offer fund has requested withdrawal from its portfolio hedge funds—even for several months, if necessary. This feature would allow a tender offer fund to determine its liquidity needs only after the tender offer has been completed. Furthermore, many tender offer funds invest in hedge funds with an "audit holdback" requirement, whereby a certain portion of the hedge fund investor's withdrawal proceeds will be held back until a hedge fund level audit has been conducted and the withdrawal proceeds amount has been confirmed. Tender offer funds regularly institute a similar policy with respect to their own shareholders. For example, some tender offer funds commit to paying ninety percent of redemption proceeds within thirty, sixty or even ninety days. Such a tender offer fund will distribute the balance of tender offer proceeds only after it has conducted its own audit. This feature allows tender offer funds to invest in a broader range of asset categories and time payment of redemption proceeds with the liquidity of their underlying investments. Because of this flexibility, the tender offer fund structure has been the vehicle of choice for registered funds of hedge funds, despite the enhanced disclosure obligations required by tender offers conducted in accordance with Rule 13e-4.

Both interval funds and tender offer funds have also sought and been provided exemptive relief under Sections 17(d) and 57(a)(4) of the 1940 Act and Rule 17d-1 thereunder to permit such funds to participate in certain co-investment programs and certain other joint investments that would otherwise be prohibited. The relief generally permits the recipients of the relief to co-invest in portfolio companies with each other and with affiliated entities. Further, the relief generally permits the recipients to

make additional investments in the same issuer. The common form of relief generally requires, among other things, that the recipient fund's adviser make certain reports and recommendations regarding the appropriateness of an initial or follow-on investment or disposition of such investment to the fund's board and a majority of the fund's independent directors to approve such transaction. While this exemptive relief is not necessary for the operation of the interval fund or tender offer fund, it is very commonly applied for by such funds and their advisers, particularly where the fund is part of a larger fund complex.

DISTRIBUTION OF SHARES

Public Offering

Both interval funds and tender offer funds generally rely on Rule 415 under the Securities Act to offer their shares on a continuous or delayed basis to the public.[33] Historically, interval funds presented several advantages over tender offer funds. Interval funds rely on Securities Act Rule 486, which was adopted contemporaneously with Rule 23c-3, for their post-effective amendments to become immediately effective without SEC review. This allowed interval funds to take advantage of market opportunities when raising capital and to reduce the time and expense involved in making a public offering compared to a traditional closed-end fund or interval fund offering. Conversely, a tender offer fund was required to file a post-effective amendment under Section 8(c) of the 1940 Act to its existing registration statement, which required SEC review. While the staff historically provided no-action relief to non-interval closed-end funds to allow their registration statements to become effective automatically after sixty days under Rule 486(a), no such relief had ever been offered to such funds for immediate effectiveness under Rule 486(b). Accordingly, all registration statement amendments of non-interval closed-end funds, including those filed solely to register additional shares, were subject to a minimum 60-day wait and SEC review.

In 2020, the SEC adopted amendments and new instructions to Form N-2 that permitted certain eligible funds to file a short-form registration statement on Form N-2. These amendments permit closed-end funds and business development companies to file a short-form registration statement, similar to Form S-3—the short-form registration statement filed by operating companies—allowing closed-end funds to rely on Rule 430B to omit certain information from the prospectus at the time the registration statement becomes effective, so long as such information is provided by a subsequent prospectus supplement. These short-form registration statements may incorporate certain past and future Exchange Act reports by reference, therefore allowing a fund to avoid the need to make a post-effective amendment to, for example, add audited financial statements.

At the same time as it amended Form N-2, the SEC amended Rule 486. These amendments allow any interval fund or closed-end fund or business development company fund that conducts a continuous offering under Rule 415(a)(1)(ix) to rely on Rule 486.[34] Under these amendments, a qualifying closed-end fund's registration statement can become immediately effective under Rule 486(b) if it is filed for no purpose other than one or more of the following:

- Registering additional shares for which a registration statement filed on Form N-2 is already effective;
- Updating financial statements;
- Designating a new effective date for a previously filed post-effective amendment;
- Updating information regarding portfolio managers;

- Making non-material changes;
- Complying with the requirements of Rule 415(a)(5) and (6); and/or
- Any other purpose the SEC may approve.

If an amendment is filed for other purposes, qualifying funds may still rely on Rule 486(a) for automatic effectiveness after sixty days, which was previously only available to non-interval funds with appropriate exemptive relief.[35] In connection with these amendments, the SEC rescinded the previous no-action letters it had previously granted to funds regarding reliance on Rule 486(a).

Additionally, the SEC adopted amendments to Rule 23c-3, allowing interval funds to register an indefinite number of securities. Similar to ETFs and mutual funds, an interval fund is now required to pay registration fees based on its net issuance of shares, within ninety days of the end of the fund's fiscal year. An interval fund must file the information related to the calculation of the registration fee on Form 24F-2 under the 1940 Act.[36] Tender offer funds, however, were not included in these amendments. Accordingly, unless a tender offer fund is exchange-traded and is eligible to register an indefinite amount of shares under Rule 456(d), such tender offer fund must periodically update its registration statements to register new shares and is not permitted to net creations against redemptions for purposes of registration fee calculations.

Multiple Share Classes and Master-Feeder Structure

Closed-end funds are generally prohibited under Section 18 of the 1940 Act from offering multiple share classes. However, closed-end funds, including interval funds and tender offer funds, have been successful at securing exemptive relief from the SEC in order to offer multiple common share classes, and the SEC now routinely grants such exemptive requests in a timely fashion.[37] A multiclass arrangement affords closed-end funds the opportunity to tailor each class for specific distribution channels and allows for differing fees for a variety of fund services. This relief lets closed-end funds better compete with both mutual funds and private funds, which are not similarly limited in the classes of beneficial interests they may offer. However, comparable to the prohibition imposed on mutual funds by Rule 18f-3 under the 1940 Act, as a condition to their multiple-share class exemptive relief, closed-end funds are prohibited from having different advisory fees charged to share classes within the same fund.

In order to circumvent the restriction on differing advisory fees, some closed-end funds have instead opted for a master-feeder structure. In a master-feeder arrangement, one or more "feeder" funds will invest all or nearly all of their assets in a single "master" fund that will actually execute the investment strategy. Each feeder fund is a separate legal entity registered under the 1940 Act whose shares are offered pursuant to an effective registration statement under the 1933 Act. The master fund may also be a registered investment company, but this is not a requirement. While a master-feeder structure would impose significant additional obligations on a fund sponsor compared to a single fund with multiple share classes, this arrangement permits maximum flexibility to a fund sponsor. A master feeder fund could vary the terms of each feeder fund such that each feeder fund could contain different sales loads, advisory fees, incentive fees, distribution fees and redemption frequencies, while at the same time gaining exposure to the exact same investment strategy through the master fund. More than twenty tender offer fund complexes have adopted a master-feeder structure.

Blue Sky Notice Filings and Fees

Securities of registered investment companies are "covered securities" for purposes of Section 18 of the Securities Act. Section 18 exempts covered securities from all state "blue sky" securities laws relating to registration or qualification requirements. However, unless an investment company security is also a covered security under Section 18(b)(1) because it is "listed, or authorized for listing, on a national securities exchange," the offering of such securities is still subject to each state's notification filing and fee laws. Generally, because shares of interval funds and tender offer funds are not listed on an exchange, sponsors of these funds will coordinate for the notice filing to be made in any state or territory where they intend to conduct an offering. The cost of making such filings and paying the corresponding fees in all fifty states is generally in excess of $20,000.

FINRA

Until recently, offerings of closed-end fund securities were subject to the Financial Industry Regulatory Authority, Inc.'s ("FINRA") Corporate Financing Rule.[38] The Corporate Financing Rule prohibits unfair underwriting arrangements in connection with the public offering of securities and requires member firms participating in a public offering (subject to various filing exemptions) to file information with FINRA regarding the underwriting terms and arrangements. Prior to 2020, an exemption from the Corporate Financing Rule existed for interval funds that make periodic repurchases pursuant to Rule 23c-3 and make a continuous offering of their securities pursuant to Securities Act Rule 415; however, no similar exemption existed for closed-end funds operating as tender offer funds. In 2020, FINRA adopted amendments to the Corporate Financing Rule exempting tender offer funds that make continuous offerings under Rule 415, price their securities at least quarterly, impose certain limits on compensation to underwriters, make at least two repurchase offers each calendar year and do not list their securities on a national securities exchange.

PERFORMANCE FEES

Advisers to closed-end funds, including interval funds and tender offer funds, are prohibited by Section 205 of the Investment Advisers Act of 1940 (the "Advisers Act") from charging a performance fee, subject to a few exceptions. A closed-end fund may charge a performance fee if all of the fund's shareholders are "qualified clients" as defined in Rule 205-3 under the Advisers Act. The definition includes, among other things, natural persons or companies with at least $1.1 million in assets under management with the adviser or who have a net worth of at least $2.1 million (disregarding the value of such person's principal residence).[39] Because the language of Section 205 prohibits a performance fee "on the basis of a share of capital gains upon or capital appreciation of" a fund, performance fees based on dividend and interest income are generally permissible. Furthermore, under Section 205(b)(2) of the Advisers Act and Rule 205-1 thereunder, closed-end funds may also charge a "fulcrum fee." A fulcrum fee is a type of performance fee that increases or decreases with investment performance as measured against an appropriate index. A fulcrum fee allows an adviser to receive a performance fee when its investment performance exceeds the performance of an index, but it also requires the adviser to provide for the subtraction of losses when fund performance is less than the performance of the benchmark index. While fulcrum fees are used in only a minority of registered investment companies, they have received increased attention recently as a possible alternative to traditional performance fees.

Many interval funds and tender offer funds pursue a fund-of-funds strategy whereby they invest fund assets in other privately offered investment companies, such as hedge funds, private equity funds or private debt funds. The underlying private funds may themselves charge a performance fee. If an interval fund or tender offer fund invests in a private fund relying on the Section 3(c)(1) exemption under the 1940 Act that charges a performance fee, then that interval or tender offer fund must limit its sale to qualified clients. Alternatively, interval or tender offer funds may invest in Section 3(c)(5) and (7) fund and private REITs that charge performance fees without imposing a qualified client limitation. The SEC has generally required that the offering of such fund-of-funds be limited only to "accredited investors" within the meaning of Rule 501 of Regulation D under the Securities Act.

LEVERAGE

Both interval funds and closed-end funds are generally subject to the same leverage requirements applicable to all closed-end funds. Section 18 of the 1940 Act restricts a closed-end fund's issuance of an evidence of indebtedness unless the fund has 300% asset coverage,[40] and preferred stock unless the fund has 200% asset coverage.[41] This restriction grants closed-end funds more flexibility than mutual funds, which are unable to issue preferred stock and are generally limited to bank borrowing as a source of leverage. However, interval funds are subject to several additional leverage requirements not applicable to tender offer funds and other closed-end funds. Any senior security issued by an interval fund or other indebtedness contracted by an interval fund must either (1) mature by the fund's next repurchase pricing date or (2) provide for the redemption, call or repayment of the security by the next repurchase offer pricing date.[42] These restrictions tend to prevent an interval fund from taking on leverage that would interfere with its next scheduled repurchase offer. Tender offer funds, on the other hand, do not face similar restrictions as to the type of senior securities and may issue any type of senior security any other non-interval closed-end fund may issue. Subject to the foregoing limitations, both interval funds and tender offer funds may also use derivatives and other instruments that have the effect of creating leverage. Where these instruments are used, a closed-end fund must generally segregate assets in an amount necessary to cover any obligations that may arise.

Prior to the adoption of Rule 18f-4 under the 1940 Act in 2020, unfunded commitment agreements entered into by closed-end funds were considered a form of leverage and were required to be considered in the leverage restrictions imposed by Section 18. This placed a significant restriction on those interval and tender offer funds that sought to invest in private funds that admitted limited partners through a capital commitment, rather than an upfront cash subscription, as is common practice for many private equity funds. With the adoption of Rule 18f-4, a closed-end fund may enter into unfunded commitment agreements outside of the limitations of Section 18 if, at the time of entering into such an agreement, a fund believes it will have sufficient cash and cash equivalents to meet its obligations with respect to all of its unfunded commitment agreements. Funds must consider other obligations (including any obligation with respect to senior securities or redemptions) and may not take into account cash that may become available from the sale of any investment at a price that deviates significantly from the market value of those investments, or from issuing additional equity. Funds are required to document the basis for their reasonable belief and maintain such records for at least five years.

CONCLUSION

While interval funds and tender offer funds have not historically accounted for a large portion of the registered investment companies, developments in the investment management industry are causing many fund sponsors to reexamine these fund structures as potential vehicles for new products. These types of funds provide managers with an investment vehicle to deliver exposure to alternative investment strategies and asset classes that are not suitable for open-end funds, all while avoiding some of the problematic features of traditional closed-end funds. The choices between the two structures and the flexibility each provides allow a fund sponsor to customize its investment vehicle in order to optimize its product for investors.

NOTES

1 Rule 22e-4 under the 1940 Act, commonly known as the liquidity risk management program rule, requires, among other things, certain open-end funds and exchange-traded funds to establish and maintain a liquidity risk management program overseen by a designated liquidity risk management administrator. The rule requires funds to comply with a 15% limit on illiquid securities.

2 *See, e.g.,* NYDIG Bitcoin Strategy Fund.

3 *See, e.g.*, Stone Ridge Art Risk Premium Fund.

4 *See, e.g.,* Apollo S3 Private Markets Fund.

5 Interval funds are not limited to any particular form of organization; thus, their securities may be in the form of shares, units, interests, etc. For purposes of this white paper, we refer to investors in a fund as shareholders and the equity interests in a fund as shares.

6 Initially, these closed-end funds were all loan participation or "prime rate" funds that invested in illiquid assets consisting of interests in senior, secured corporate loans that had floating interest rates. In 1991 the Emerging Markets Growth Fund, Inc., became the first closed-end fund with an equity-focused investment strategy to indicate its intention to offer periodic repurchases of its shares.

7 1940 Act Release No. 19399 (May 14, 1993).

8 As discussed below, many closed-end funds that operate as tender offer funds are part of a master-feeder structure (see, e.g., FS Global Credit Opportunities Fund). For purposes of counting the number of tender offer funds, we have considered all funds within a master-feeder structure as a single tender offer fund. When counting each master or feeder fund as a single fund, the number of tender offer funds is in excess of one hundred.

9 Rule 23c-3(b)(2)(i).

10 Rule 23c-3(b)(2)(ii).

11 Rule 23c-3(a)(1); Rule 23c-3(b).

12 *See, e.g.,* Blackstone/GSO Floating Rate Income Fund, *et al.,* 1940 Act Release No. 32866 (Notice) (Oct. 23, 2017); 1940 Act Release No. 32901 (Order) (Nov. 20, 2017).

13 Rule 23c-3(a)(7).

14 Rule 23c-3(c).

15 Rule 23c-3(b)(3)(i).

16 Rule 23c-3(b)(3)(ii).

17 Rule 23c-3(a)(3). As a condition to the SEC providing exemptive relief to certain interval funds intending to conduct monthly repurchases (*see, e.g.,* note 16 above), such funds must offer to repurchase not less than five percent of the fund's outstanding shares in any one-month period, and the repurchase offer amount for the then-current monthly period, plus the repurchase offer amounts for the two monthly periods immediately preceding the then-current monthly period, must not exceed twenty-five percent of the fund's outstanding common shares.

18 Rule 23c-3(a)(3).

19 Rule 23c-3(b)(5).

20 Rule 23c-3(b)(7).

21 Rule 23c-3(b)(4)(i).

22 Rule 23c-3(b)(4)(ii).

23 Rule 23c-3(a)(5)

24 Rule 23c-3(a)(4).

25 Rule 23c-3(b)(4)(i).

26 Rule 23c-3(b)(10)(i).

27 Rule 23c-3(b)(1).

28 Rule 13e-4(f)(3).

29 Rule 13e-4(b). The rule provides a variety of ways to disseminate the required information to shareholders.

30 Rule 13e-4(f).

31 Rule 13e-4(f)(5).

32 Exchange Act Rule 14d-100 (Schedule TO).

33 Interval funds are able to rely on Rule 415 on the basis of meeting the express requirements of Rule 415(a)(1)(xi), which was adopted contemporaneously with 1940 Act Rule 23c-3. Pursuant to SEC exemptive relief, most other closed-end funds, including tender offer funds, make continuous or delayed offerings on the basis of Rule 415(a)(1)(x), even though they do not satisfy the express requirements of the rule. See Pilgrim America Prime Rate Trust, SEC Staff No Action Letter (May 1, 1998); Nuveen Virginia Premium Income Municipal Fund, SEC Staff No-Action Letter (Oct. 6, 2006).

34 *See* Rule 415(a)(1).

35 Rule 486(a).

36 Rule 23c-3(e).

37 As part of these exemptive relief requests, funds will routinely request and receive relief to charge shareholders a distribution fee (i.e., a 12b-1 fee).

38 FINRA Rule 5110.

39 These dollar thresholds are adjusted periodically by the SEC for inflation. The next such inflation adjustment will occur on or about May 1, 2026.

40 1940 Act Section 18(a)(1)(A). Asset coverage for debt securities is calculated as the ratio of the value of total fund assets, less all liabilities and indebtedness not represented by senior securities, to the aggregate amount of debt securities. Section 18(h).

41 1940 Act Section 18(a)(2)(A). Asset coverage for preferred shares is calculated as the ratio of the value of the fund's total assets, less all liabilities and indebtedness not represented by senior securities, to the aggregate amount of debt securities issued by a fund plus the aggregate of the involuntary liquidation preference on the preferred shares. Section 18(h).

42 Rule 23c-3(b)(9).

FOR MORE INFORMATION

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APPENDIX I

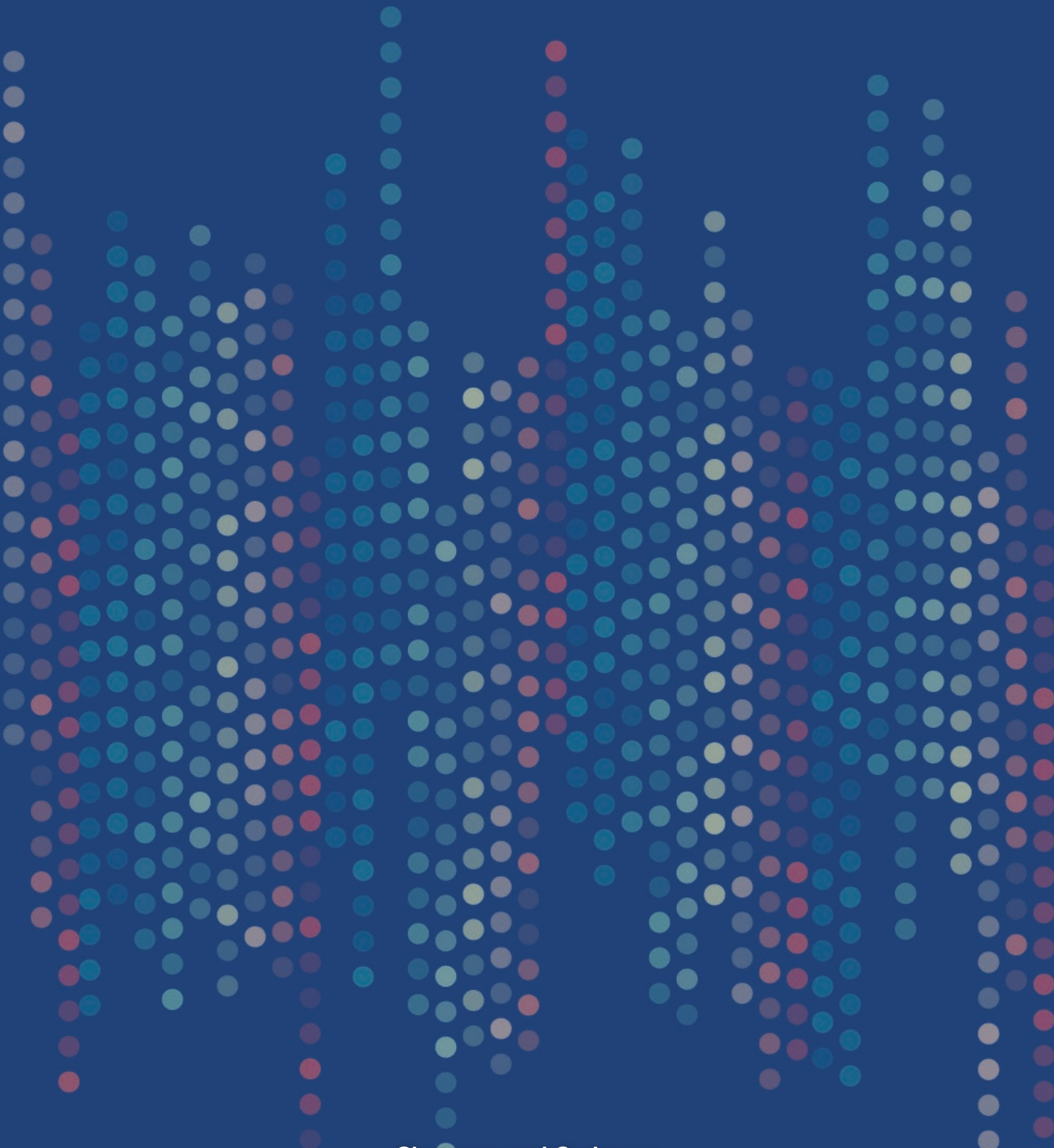
COMPARISON OF INVESTMENT VEHICLES

The following table sets forth a brief summary of the general rules applicable to or general market practice of the following investment vehicles. The rules and practices summarized below are not a complete description of any law, regulation or practice.

	Interval Fund	Tender Offer Closed-End Fund	Traditional Closed-End Fund	Open-End Mutual Fund	Hedge Fund	Private Equity/ Real Estate Closed-End Fund
Eligible Investors	Any investor	Any investor	Any investor	Any investor	Limited to investors that are "accredited investors" and "qualified purchasers" (if a 3(c)(7) fund)	Limited to investors that are "accredited investors" and "qualified purchasers" (if a 3(c)(7) fund)
Frequency of Calculating NAV	Weekly, except daily during five business days before repurchase offer request deadline	Varies	Generally daily	Daily	At the discretion of the fund manager in accordance with the fund's governing documents	At the discretion of the fund manager in accordance with the fund's governing documents
Performance Fee	Generally no unless (1) sales are limited to "qualified clients," (2) fund charges a "fulcrum fee," or (3) performance fee is based only on dividend or interest income	Generally no unless (1) sales are limited to "qualified clients," (2) fund charges a "fulcrum fee," or (3) performance fee is based only on dividend or interest income	Generally no unless (1) sales are limited to "qualified clients," (2) fund charges a "fulcrum fee," or (3) performance fee is based only on dividend or interest income	Generally no unless (1) sales are limited to "qualified clients," (2) fund charges a "fulcrum fee," or (3) performance fee is based only on dividend or interest income	Yes, subject to conditions	Yes, subject to conditions
Distribution (12b-1) Fee	Yes, with exemptive relief	Yes, with exemptive relief	Yes, with exemptive relief	Yes	N/A	N/A
Multiple Share Classes	Yes, with exemptive relief	Yes, with exemptive relief	Yes, with exemptive relief	Yes	Yes	Yes

	Interval Fund	Tender Offer Closed-End Fund	Traditional Closed-End Fund	Open-End Mutual Fund	Hedge Fund	Private Equity/ Real Estate Closed-End Fund
Liquidity Restrictions	Liquidity restrictions apply during period between notice of repurchase and the repurchase pricing date	None, but must be able to fulfill tenders "promptly"	None	Illiquid securities limited to 15% of net assets	None	None
Redemption Frequency	At intervals of twelve, six or three months, or one month with exemptive relief	At the discretion of the board	N/A	Required to meet all daily redemptions	At the discretion of the fund manager in accordance with the fund's governing documents	Generally redemptions are not permitted
Redemption Amount	Between 5%-25% of outstanding shares	At the discretion of the board	N/A	Unlimited	At the discretion of the fund manager in accordance with the fund's governing documents	Generally redemptions are not permitted
Timing of Payment of Redemption Proceeds	Redemption proceeds must be paid within seven days of repurchase pricing date	Redemption proceeds must be paid "promptly," but can be timed with liquidity of fund assets	N/A	Redemption proceeds must be paid within seven days of redemption request	At the discretion of the fund manager in accordance with the fund's governing documents	N/A
Redemption Fees	Maximum 2% of proceeds	Subject to discretion of fund manager	N/A	Permissible in some circumstances, depending on share class	At the discretion of the fund manager in accordance with the fund's governing documents	Generally redemptions are not permitted
Subject to FINRA Corporate Financing Rule	No	No, subject to exemption conditions	Yes, if exchange traded	No	No	No

	Interval Fund	Tender Offer Closed-End Fund	Traditional Closed-End Fund	Open-End Mutual Fund	Hedge Fund	Private Equity/ Real Estate Closed-End Fund
Leverage	1 Leverage is subject to asset coverage requirements of Section 18 of the 1940 Act; and 2 Senior securities must mature or be callable/ redeemable by the next repurchase pricing date	Use of leverage and senior securities are subject to the requirements of Section 18 of the 1940 Act	Use of leverage and senior securities are subject to the requirements of Section 18 of the 1940 Act	1 Use of leverage is subject to asset coverage requirements of Section 18 of the 1940 Act; 2 Senior securities are not permitted; and 3 Borrowing is only permitted from banks	No restrictions	No restrictions
Blue Sky Requirements	Notice filing and fee payment required in all states in which an offering is made	Notice filing and fee payment required in all states in which an offering is made	Exempt if securities are listed on a national exchange	Notice filing and fee payment required in all states in which an offering is made	Notice filing and fee payment required in all states in which an offering is made	Notice filing and fee payment required in all states in which an offering is made



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