

# Interval and Tender Offer Funds

What to consider when entering the marketplace

2024

# Contents

Introduction .....	3
History.....	5
Interval Funds.....	6
Tender Offer Funds .....	8
Tender Offer vs. Interval Funds.....	9
Launching Tender Offer + Interval Funds .....	11
Distribution.....	14
About ACA.....	19

# Introduction

Non-traditional closed-end interval and tender offer funds (collectively, closed-end funds) constitute an important segment of the investment industry. Closed-end funds' regulatory and investment features straddle between private funds (e.g., private equity and hedge funds) and open-end funds (e.g., mutual funds and exchange-traded products). Their unique structure allows asset managers to deliver alternative and illiquid investment strategies to a broad investor base.



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This white paper distills closed-end funds' regulatory framework and operational considerations for existing and prospective closed-end fund asset managers. We will guide you through their regulatory intricacies, offering comparisons between interval funds and tender offer funds along the way. Later we will connect their structure with an examination of how closed-end funds should be approached from a distribution perspective.

Interval and tender offer funds are closed-end registered investment companies that can continuously offer shares at net asset value (NAV) to an unlimited number of investors. Closed-end funds are not exchange-listed and can provide investors liquidity through repurchases of their shares at NAV. For interval funds, repurchases are set at a predetermined frequency (every 3, 6, or 12 months); tender offer funds can conduct repurchases at their discretion.

Most often they are registered under both the Investment Company Act of 1940, as amended (Investment Company Act) and the Securities Act of 1933, as amended (Securities Act). However, some closed-end funds are not registered under the Securities Act and may raise capital through private placement transactions pursuant to Regulation D.

Closed-end funds differ from both traditional closed-end funds (traditional CEFs) that are publicly traded and open-end funds, e.g., mutual funds and exchange-traded products (ETPs). Traditional CEFs issue shares in an initial public offering. Thereafter, they do not continuously offer shares, and they publicly list the shares for trading on a stock exchange, requiring registration of those shares under the Securities Exchange Act of 1934, as amended (Exchange Act). While closed-end funds offer periodic liquidity through share repurchases, open-end funds are the most liquid investment company type that continuously offer shares. Open-end funds conduct daily repurchases for investor liquidity, with ETPs providing intraday investor liquidity.

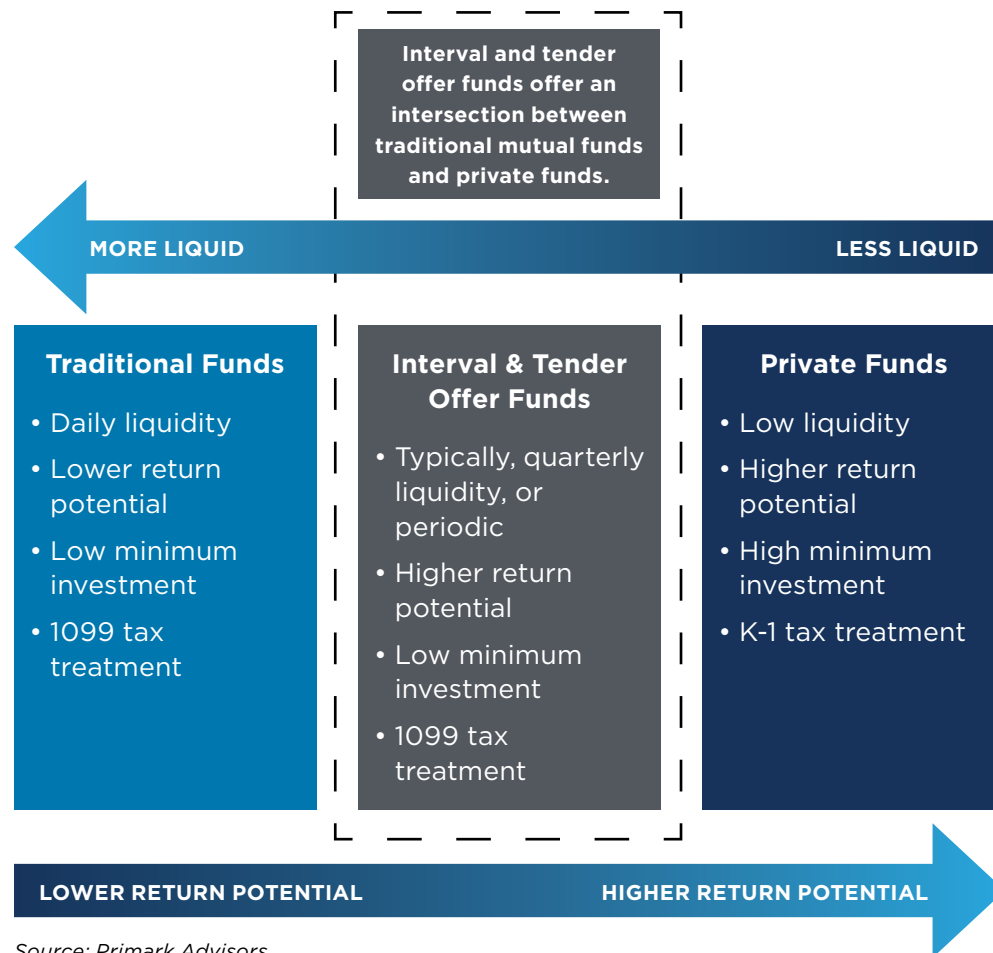
Closed-end funds allow asset managers to efficiently manage investor redemptions with predetermined liquidity windows and therefore are better suited to hold illiquid or alternative investments that may have longer holding periods. In this respect, closed-end funds parallel private funds. However, private funds rely on exemptions from the Securities Act and Investment Company Act that restrict their investor base.

For example, section 3(c)(1) of the Investment Company Act exempts a fund from registration, but it requires investors to be "accredited investors" and caps the number of investors at 100. Section 3(c)(7) of the Investment Company Act is also available as an exemption from registration, but investors must be "qualified purchasers" (i.e., a person with at least \$5 million in investments).

Closed-end funds are a blend in structure between private funds and open-end funds, and thus have attracted a range of asset managers seeking to access the unique investment wrapper. Private fund managers may have existing investment vehicles or portfolios that hold illiquid securities and are not conducive to the liquidity needed for an open-end fund. Additionally, offering restrictions under Section 3(c)(1) or Section 3(c)(7) may motivate private fund managers to investigate the suitability of the closed-end fund structure for reaching a broader and more retail-based investor.

On the other hand, open-end fund managers may wish to deploy a more illiquid investment portfolio or have greater portfolio control in meeting predetermined redemptions. In particular, closed-end funds are not subject to liquidity restrictions under Rule 22e-4 of the Investment Company Act. Under Rule 22e-4, open-end funds must adhere to their liquidity risk management program whereby, among other requirements, illiquid holdings (i.e., securities that cannot be sold in 7 days or less without significant devaluation) are constrained to 15% of net assets.

Closed-end funds are also being received better in the dealer and financial intermediary community and thus gaining recognition among investors. Closed-end funds are an attractive investment vehicle for investors that are comfortable with the more limited liquidity structure and are seeking portfolio diversification through access to private and alternative strategies. In most cases, closed-end funds' investment minimums and investor eligibility standards are lower compared to private funds with similar strategies.



Source: Primark Advisors

# History

Unlike the more recently created interval fund structure, today's tender offer funds date back to the early twentieth century — a time when closed-end funds were the most prominent investment company type. In 1940, when the Investment Company Act established the classification system for traditional closed-end and open-end management investment companies, assets in open-end funds equaled only two-thirds the value of traditional CEFs.<sup>1</sup> Open-end funds quickly surpassed traditional CEFs, accounting for 82% of industry assets by 1966.<sup>2</sup> By the time the closed-end interval fund structure was established in 1993, open-end funds accounted for 95% of industry assets.<sup>3</sup> The federal regulatory framework created by the passage of the Securities Act, the Exchange Act, and, ultimately, the Investment Company Act contributed to the shift in assets to open-end funds.



The history of tender offer and interval funds helps contextualize their current regulatory framework and purpose in the asset management industry.



Tender offer funds operated in an exacting regulatory environment following the passage of the Investment Company Act. The Investment Company Act inaugurated standards to counter pervasive market abuses in the 1920s and 30s. Between 1938 and 1940, the U.S. Securities and Exchange Commission's (SEC's) Study on Investment Trusts and Investment Companies chronicled these abuses.<sup>4</sup>

<sup>1</sup> <https://www.sec.gov/divisions/investment/guidance/icreg50-92.pdf>

<sup>2</sup> Ibid

<sup>3</sup> Ibid

<sup>4</sup> SEC, Investment Trusts and Investment Companies, pt. 3, H.R. Doc. No. 279, 76th Cong., 1st Sess. (1939)

<sup>5</sup> SEC, Division of Investment Management, Protecting Investors: A Half Century of Investment Company Regulation, p. 424

Among them, the study found that closed-end funds “aggressively repurchased” their discounted shares to manipulate the market for the benefit of insiders and to the detriment of shareholders. The study also cited the “dangerous leveraging effects that threatened the viability” of many closed-end funds. As a result, Congress permitted share repurchases and leverage, but subjected their use to restrictions under Section 23(c) and Section 18 of the Investment Company Act, respectively.

Additional cumbersome repurchase requirements under the Exchange Act and Securities Act have constrained sponsors. Without efficient share repurchases, sponsors were limited in their efforts to reduce the discount to NAV at which their shares were trading. In turn, trading discounts curtailed closed-end funds' ability to issue new shares and sponsors' ability to launch closed-end funds.

The maturation of tender offer funds during the 1980s, including their involvement with semi-liquid securities and the development of novel share repurchasing mechanisms, led the SEC to re-examine the classification system of investment companies and recommend changes to Section 23 of the Investment Company Act in the SEC Division of Investment Management's 1992 report. The report evidenced the “rigidity” of the classification system and sought “to chart new territory between the two extremes of the open-end and closed-end forms” by developing new investment companies with “a degree of redeemability.”<sup>5</sup> A year later, the SEC adopted Rule 23c-3 and established the closed-end interval fund structure under the Investment Company Act.

Rule 23c-3 authorizes closed-end funds (and business development companies) to make periodic repurchase offers for their own shares. The SEC further enabled share repurchases through the adoption of an [amendment](#) to the “shelf registration” rule in August 1994, Rule 486(b), to allow closed-end funds to conduct continuous or delayed offerings of their shares more efficiently and on shorter notice. The SEC's original objective for creating Rule 23c-3 as a middle ground between “two extremes” sets the stage for a more in-depth look at the current tender offer fund and interval fund structure types.

# Interval Funds: *Rule 23c-3*

An overview of Rule 23c-3 forms the foundation for understanding interval funds' fundamental structure and later will be used to compare the interval fund structure to that of tender offer funds. Rule 23c-3 delineates the regulatory framework, mechanisms, and restrictions for how interval funds conduct repurchase offers. More specifically, Rule 23c-3, among other things, establishes the permitted frequency, amount, type, and timing of repurchases for interval funds.

## Frequency

Repurchase offers can be set at intervals of 3, 6, or 12 months. Additionally, an interval fund may make a discretionary repurchase offer pursuant to Rule 23c-3 no more than once every 2 years. Unlike with periodic repurchase offers, the discretionary repurchase amount is not subject to size limitations.

## Repurchase Offer Amount

The repurchase offer amount is defined as the amount of common stock an interval fund offers for repurchase. It is calculated as a percentage of common stock outstanding and must be between (or equal to) 5% and 25%. If repurchases exceed the repurchase offer amount, interval funds must accept repurchases on a pro rata basis. Interval funds are permitted to increase the repurchase offer amount by 2% to handle an oversubscription without accepting repurchases pro rata.

## Repurchase Payment Deadline

The repurchase payment deadline occurs 7 days after the repurchase pricing date, and it requires the interval fund to pay shareholders for any common stock repurchased.

## Repurchase Pricing Date

The repurchase pricing date is the date on which the NAV for the securities being repurchased is determined. Subject to certain conditions, it must be no later than 14 days following the repurchase request deadline.

## Repurchase Request Deadline

The repurchase request deadline is the date by which interval funds must receive repurchase requests from shareholders or receive modifications to previously submitted repurchase requests.

## Repurchase Fees

Repurchase fees are paid to the interval fund to compensate for expenses directly related to the repurchase. It may not exceed 2% of the repurchase proceeds.

Rule 23c-3 requires interval funds to repurchase shares pursuant to a "fundamental policy" establishing an interval fund's intent to make periodic repurchases of its common stock. The policy must specify the frequency, dates of repurchase request deadlines (and means of determining the deadlines), and the maximum number of days between the repurchase request deadline and the repurchase pricing date. An interval funds fundamental policy may only be modified by a majority vote of the outstanding voting securities of the interval fund. Suspension or postponement of repurchase offers is only permitted under limited emergency circumstances and requires a majority vote of an interval fund's Board of Trustees (Board), including a majority of the disinterested directors. An interval fund's annual report must include a statement of its fundamental policy and outline the preceding year's repurchase offers, including the number of repurchase offers, the repurchase offer amount, and the amount tendered in each repurchase offer.

Rule 23c-3 also stipulates that interval funds must notify shareholders 21 to 42 days prior to a repurchase request deadline. The notification informs shareholders of all pertinent repurchase offer details: any repurchase-related fees, repurchase offer amount, repurchase request deadline, repurchase pricing date, repurchase payment deadline, risk of NAV fluctuation between repurchase request deadline and repurchase pricing date, procedures for withdrawing or changing their tenders, procedures for pro rata share repurchases, NAV of common stock calculated 7 or less days prior to notification, and, if applicable, the market price of the common stock.

Valuation of illiquid holdings presents challenges for closed-end funds. Interval funds must calculate NAV at least every 7 days, and NAV must be calculated daily for the 5 business days prior to a repurchase request deadline. In addition to valuation, an interval fund's Board must adopt procedures to ensure the interval fund's assets are "sufficiently liquid" to "comply with its fundamental policy on repurchases" and meet liquidity requirements by maintaining 100% of the repurchase offer amount in liquid assets.



# Tender Offer Funds: *Discretionary Repurchases*

Unlike interval funds, which conduct scheduled repurchases pursuant to Rule 23c-3, tender offer funds repurchase shares at the Board's discretion pursuant to Rule 13e-4, Section 14, and Schedule TO under the Exchange Act.

Rule 13e-4 governs tender offers by issuers. It sets forth the parameters for commencing, terminating, filing, disseminating, and generally conducting a tender offer. In contrast to Rule 23c-3, Rule 13e-4 does not require predetermined repurchase offers nor limit the repurchase offer amount. At the commencement of a tender offer, the tender offer fund will notify shareholders of the repurchase offer, complete Schedule TO, deliver the Letter of Transmittal to shareholders, and file all repurchase offer documents with the SEC.

Rule 13e-4 sets forth the parameters for commencing, terminating, filing, disseminating, and generally conducting a tender offer.

Schedule TO is the tender offer statement of the fund and includes, typically by exhibit, the Offer to Purchase and other key documents. Schedule TO must be filed as soon as practicable on the commencement of the tender offer. Schedule TO and the Offer to Purchase disclose the material information regarding what is being offered, why, when it will expire, approximate price, and any other conditions and details. The Offer to Purchase is delivered to shareholders as the official terms of the offering. Shareholders receive the Letter of Transmittal for purposes of specifying the shares that are to be tendered and providing investor identification and payment instructions. Tender offer funds will also provide a Notice of Tender Cancellation for shareholders to cancel previously submitted tenders.



# Tender Offer vs. Interval Funds

## ***Examining structural differences between tender offer and interval funds to understand product development implications***

While tender offer and interval funds are similar types of registered closed-end investment companies, their structure primarily differs in the regulatory framework for conducting repurchases. The figure below compares the interval fund structure to that of tender offer funds.

	Interval Fund	Tender Offer Fund
<b>Classification</b>	Management Investment Company	Management Investment Company
<b>Subclassification</b>	Closed-end	Closed-end
<b>Repurchase Offers</b>	Conducted at regular intervals ( <i>quarterly, semiannually, or annually</i> ) pursuant to Rule 23c-3(b) of the Investment Company Act	A tender offer fund's Board has discretion for tendering shares for repurchase, subject to Exchange Act requirements in Rule 13e-4, Section 14, and Schedule TO
<b>Repurchase Offer Amount</b>	Must be between ( <i>or equal to</i> ) 5% and 25%, calculated as a percentage of common stock outstanding	A tender offer fund's Board has discretion to determine the tender offer amount
<b>Policy Requirements</b>	"Fundamental policy" established outlining key details for scheduled repurchase offers, changeable only by a majority vote of the outstanding voting securities of the company. Annual report must publish fundamental policy and summarize preceding years repurchase offers.	Fundamental policy is not required, as that provision is required in Rule 23c-3, which is not applicable to tender offer funds.
<b>Unscheduled or Discretionary Repurchases</b>	Along with scheduled repurchase offers pursuant to its fundamental policy, an interval fund may make 1 discretionary repurchase offer pursuant to Rule 23c-3 no more than every 2 years. The discretionary repurchase amount is not subject to size limitations.	All repurchase offers are discretionary as they are determined at the discretion of the tender offer fund's Board.
<b>Offering Duration</b>	21 to 42 days, as repurchase offer notifications must be sent 21 to 42 days preceding a repurchase request deadline	At least 20 business days, and at least 10 business days after certain material changes to the tender offer
<b>Repurchase Price</b>	On the repurchase pricing date, NAV is calculated, and tendered shares must be repurchased for cash	Determined by "best-price rule" - highest consideration paid to a shareholder must be paid to all other shareholders
<b>Repurchase Fees</b>	Permitted - Paid to the interval fund to compensate for expenses directly related to the repurchase. It may not exceed 2% of the repurchase proceeds.	Permitted - Paid to tender offer fund, calculated as a percentage of repurchased amount.
<b>Oversubscription Process</b>	If repurchases exceed the repurchase offer amount, interval funds must accept repurchases on a pro rata basis. Interval funds are permitted to increase the repurchase offer amount by 2% to handle an oversubscription without accepting repurchases pro rata.	If repurchases exceed the repurchase offer amount, tender offer funds can modify the offer to accommodate the oversubscription or accept tenders on a pro rata basis, subject to other allowances for accepting tenders.

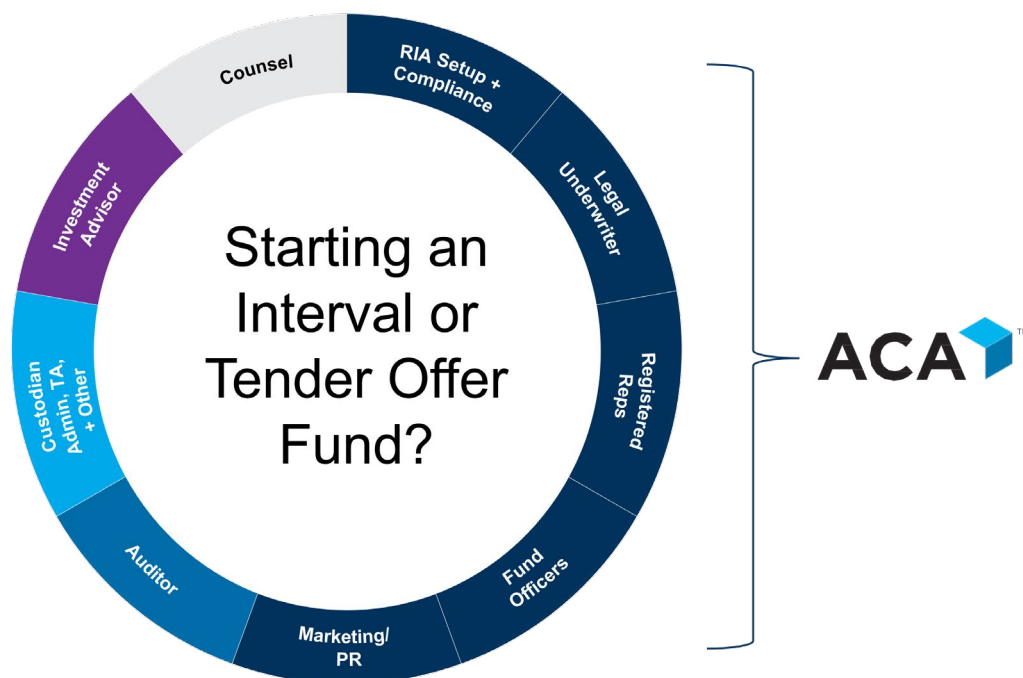
	Interval Fund	Tender Offer Fund
<b>Leverage</b>	Must meet asset coverage limitations of 300%, or 200% for preferred stock. Senior securities or other debt contracted by an interval fund must mature or provide for the redemption, call, or repayment prior to the next repurchase pricing date.	Must meet asset coverage limitations of 300%, or 200% for preferred stock. Other leverage requirements, applicable to interval funds, are not applicable for tender offer funds.
<b>Liquidity Requirements</b>	Not subject to SEC Liquidity Rule 22e-4. Interval funds must maintain 100% of the repurchase offer amount in liquid assets, defined as those “that can be sold or disposed of in the ordinary course of business” and valued at approximate repurchasing price.	Not subject to SEC Liquidity Rule 22e-4, nor interval fund liquidity restrictions.
<b>Valuation Frequency</b>	At least weekly always and at least daily for the 5 business days prior to a repurchase request deadline	Periodic

# Launching Tender Offer and Interval Funds

Asset managers seeking to launch closed-end funds will need to familiarize themselves with their peculiar regulatory standing and the service provider ecosystem. Many of the service providers and regulatory requirements that apply to private funds, mutual funds, and ETFs do not apply to closed-end funds, and vice-versa.

The chart below represents the various service providers a firm would need to launch a tender offer or interval fund.

Beginning at the most foundational step, closed-end funds are typically formed as a Statutory or Business Trust. They are governed by a declaration of trust and corporate bylaws, and they are managed by a Board of Trustees. Like all investment companies, the appointment of a closed-end fund's Board must meet the fund governance standards set forth in the Investment Company Act, including the requirement to have a majority of members be independent from the fund or its investment adviser. The declaration of trust and bylaws will determine the permitted term length of Board members and process for electing Board members at annual shareholder or other meetings.



Many mutual funds and ETFs operate within a “series company” to streamline regulatory and operational matters and reduce costs. A series company, commonly known as a series trust or multiple series trust, is a provision only available to open-end investment companies under Section 18(f)(2) of the Investment Company Act. Thus, each closed-end fund must file its own registration statement after formation as a new legal entity with seed capital of at least \$100,000. Further, Rule 485(a) permits an existing open-end fund to add additional series funds through a post-effective amendment that becomes automatically effective between 75 and 95 days after filing. However, an asset manager launching multiple closed-end funds must file separate registration statements for additional series and await the SEC’s declaration of effectiveness, which under normal circumstances, is around 90 to 120 days.

FINRA’s [Regulatory Notice 20-10](#) amended the Corporate Financing Rule to exempt tender offer funds from filing requirements and other provisions, pursuant to the newly amended FINRA Rule 5110. The Corporate Financing Rule regulates the underwriting terms and arrangements of an offering. Historically, FINRA was required to review and approve the underwriting arrangement of tender offer funds. (Interval funds were, and still are, exempt). This new exemption has lowered the cost and eased one of the regulatory hurdles for launching tender offer funds.

### Service Providers

As with any investment fund launch, service provider selection is a critical step. An anchor relationship with a service provider can help serve as a central resource for understanding the operational aspects needed to launch, including evaluating and appointing service providers.

In almost all cases, the asset manager launching a closed-end fund (or an affiliate thereof) will serve as the fund’s investment adviser. The investment adviser of any investment company, including closed-end funds, must be registered with the SEC as an investment adviser under the Advisers Act. Additionally, the investment advisory agreement must follow guidelines set forth in Section 15 of the Investment Company Act.

Among other requirements, the investment advisory agreement must:

- » Set forth the specific compensation arrangement. Closed-end funds’ advisory fee is typically an annual rate calculated as a percentage of NAV and paid monthly or quarterly in arrears.
- » Be approved annually after an initial two-year term. A majority must approve the initial appointment of an investment adviser of shareholders, majority of the Board, and majority of the disinterested Board members. The annual appointment (following the two-year term) is more specifically outlined in Section 15(c) of the Investment Company Act. Section 15(c) places the “duty of the directors of a registered investment company to request and evaluate” the terms of any investment advisory agreement. A Board meeting must be set for the specific purpose of renewing the investment advisory agreement, at which point a majority of disinterested Board members must approve.
- » *Allow termination at any time, such that termination is without penalty and can become effective no more than 60 days following written notice.*

Section 205(a)(1) of the Advisers Act prohibits an investment adviser from receiving performance fees – i.e., compensation based on capital gains or capital appreciation. However, Rule 205-3 under the Advisers Act exempts investment advisers from this restriction if all shareholders are “qualified clients,” as defined in Rule 205-3(d)(1) under the Investment Advisers Act. A Qualified Client is a natural person who (i) has \$1 million in assets under management with the investment adviser after entering into the advisory contract; (ii) has a net worth greater than \$2.1 million (excluding primary residence and other restrictions); or (iii) who meets the definition of a “qualified purchaser” or “knowledgeable employee.”

### Investment Adviser

An investment adviser must be appointed in accordance with guidelines established in Section 15(c) of the Investment Company Act. The investment adviser will have the authority to invest the fund’s assets consistent with the fund’s stated strategy and investment restrictions.

### Principal Underwriter

Principal underwriter (or distributor or placement agent) must be registered as a broker-dealer with the SEC under the Exchange Act and be a member of the Financial Industry Regulatory Authority (FINRA). Similar to the investment advisory agreement, the principal underwriting agreement’s initial term can be no more than 2 years, and, thereafter, must receive annual Board approval, as established in Section 15(c) of the Investment Company Act. Unlike investment advisory agreements, the principal underwriting agreement does not require shareholder approval.

### Legal Counsel

Closed-end funds will work closely with legal counsel to receive expertise in a range of legal, compliance, and operational areas.

### Administrator

The administrator is responsible for the general back-office operations of a closed-end fund. Oftentimes, this will include accounting, preparing financial statements, determining NAV, and filing SEC reports. With illiquid and/or hard-to-value securities, it is imperative the fund’s investment adviser works closely with its administrator and auditor to ensure valuation methodology is consistent with all policies, procedures, and other requirements.

### Transfer Agent

The transfer agent is responsible for maintaining share ownership records and transactions, disbursing dividend payments, and preparing and delivering other shareholder notices.

### Custodian

Closed-end funds must custody its securities at an eligible custodian, typically a bank. There are several custody requirements, including in areas such as use of margin and foreign custody arrangements.

### Auditor

Closed-end funds must retain an auditor (independent registered public accounting firm), in accordance with Section 32 of the Investment Company Act.

### Fund Officers

Closed-end funds must appoint a chief compliance officer, treasurer, and other officers. These positions can be outsourced.

# Distribution

For an asset manager to be successful in approaching the marketplace with any investment product structure, distribution needs to be a focus throughout the product lifecycle, especially prior to launch. Knowledge of the intermediary and investor landscape, as well as the service provider ecosystem, must be understood early in the process and is especially important to begin tackling the complexities of the closed-end product structure.

Asset managers evaluating launching a closed-end fund need to understand their target audience and the increased operational and servicing complexities the structure introduces to distribution. Asset managers will naturally cultivate success through a commitment to education, patience in the market, and thorough appreciation for the complexities and fees associated with making the product available.

	<b>Dually Registered (40/33 acts)</b>	<b>40-Act Only</b>	<b>Exempt from 40/33 Acts (private fund)</b>
<b>Target Audience</b>	Retail Investors	HNW/ Accredited Investors	Qualified Purchasers/ Accredited Investors
<b>Trade + Settlement</b>	NSCC	AIP/Check & App	AIP/Check & App
<b>Platform support</b>	Traditional	Alternative	Alternative
<b>Tax treatment</b>	1099	1099	K-1
<b>Forside Role</b>	Legal Underwriter	Legal Underwriter/ Placement Agent	Placement Agent

## Rise In Popularity

The historical market growth of closed-end funds continues to be supported by a mutually beneficial supply and demand relationship between asset managers and investors. On the supply side, asset managers can utilize the closed-end fund structure to package less liquid and alternative investment strategies to access a new investor base not currently served by their product offerings.

On the demand side, main street investors searching for non-correlated sources of returns can access alternative and private market investments that traditionally had only been accessible to institutional investors.

The asset management industry has recognized the growing importance of closed-end funds for asset managers and investors in the current market environment. As such, industry groups, financial intermediaries, and other stakeholders have all sought to increase investors' access to closed-end funds. Industry groups continue to work collectively to identify operational solutions to help minimize the risk of supporting a nuanced product structure. Similarly, financial intermediaries have begun to clearly outline the onboarding process in response to investor demand for higher yields and novel investment opportunities.

## Asset Manager Perspective

There are many attractive reasons asset managers find the closed-end fund structure appealing.

- » For asset managers that specialize in alternative strategies, the creation of a retail product allows access to an untapped group of investors. With previous focus on institutional clients and accredited investors, the vast number of potential investors is enticing.
- » Closed-end funds can determine the liquidity offered to investors (i.e., 3-, 6-, or 12-month intervals for interval funds; discretionary for tender offer funds), thus relinquishing the need to meet daily outflows associated with open-end mutual funds.
- » Because closed-end fund managers have reduced obligations to meet redemption requests, they are able to invest in assets or implement investment strategies that may be less liquid and more suited to longer holding periods. The closed-end fund structure alleviates the concern of an asset manager being forced to sell out of an illiquid holding to support shareholder redemptions.

That said, there are also challenges that need to be considered prior to committing.

- » The introduction of a new investor base also introduces the need to understand the nuances of retail and broad-based advisory distribution.
- » Depending on the other products managed by the adviser (e.g., hedge fund), creating a similar strategy in a retail vehicle may result in cannibalization as investors seek to access the strategy in a lower cost wrapper.



### Platform and Intermediary Considerations

Intermediaries seek to strike a balance to meet the changing needs of its investor base by offering a diverse set of products and strategies while limiting the operational, oversight, and financial risks introduced by supporting a vast range of investment vehicles.

As investors seek to add illiquid investments to their portfolio (yield and diversification/non-correlated sources of returns), it is incumbent upon financial intermediaries (or platforms) to offer and support products that deliver value and diversification.

Over the years, platforms have been hesitant to offer these products as the existing platform infrastructure was not designed to support the trade settlement features of a closed-end fund structure compared to traditional daily settlement open-end funds. Early efforts to support these non-traditional vehicles through existing platforms introduced inefficiencies, potential errors, and contributed to a negative customer experience.

Operationally speaking, the platforms perceive each redemption window as a temporary removal of the product off the assembly line in relation to open-end funds that mandate daily redemptions. Periodic redemptions through the same infrastructure presents risks for platforms. Non-standard routines and a potential communication breakdown may present liability to service providers or other participants for a failed investor redemption.

Intermediary platforms that offer closed-end funds may require additional investor demand, conduct a more extensive due diligence review, and charge higher fees.

As a result, intermediary platforms that offer closed-end funds alongside traditional open-end mutual funds typically have more stringent onboarding requirements for the closed-end funds. They may require additional investor demand, conduct a more extensive due diligence review, and charge higher fees due to the operational restrictions associated with supporting these products. They also mandate adoption of industry utilities such as DTCC National Securities Clearing Corporation (NSCC), MF Info Xchange, and [Mutual Fund Profile II](#) as part of the operational requirements to make the product available. MF Info Xchange is a centralized communication platform between funds and intermediaries which facilitates time-critical notifications while Profile II provides a database of key fund prospectus and operational rules. Additionally, intermediaries face internal suitability and/or advisory fiduciary challenges when determining the scope of availability within its walls. It is important to keep in mind not all intermediaries support this structure for onboarding and use by their advisor base.

Access at the platform level may deviate based on how the product trades either through NSCC or Alternative Investment Product (AIP) Services. Additionally, certain platforms might be driven by third-party due diligence providers who evaluate the risk and rewards of the strategy and the merits of the manager to deliver in this wrapper. The platforms may indeed rely on those resources as a component of their decision-making process.

Closed-end funds can either be offered through the NSCC or AIP. NSCC is typically used by traditional mutual funds to provide clearing, settlement, risk management, and information services to the financial industry. AIP standardizes the way global market participants communicate information concerning alternative investments, removing the manual operational challenges that can be associated with these types of products.

Certain platforms have requirements that specify whether the funds are supported through NSCC and/or AIP. However, a retail-oriented investor base will be traded through the NSCC. For subscription-based funds not registered under the Securities Act, these are typically offered through AIP.



## Investor Perspective

Understanding, educating, and reaching a new investor base presents challenges for asset managers.

The product structure can be complex for investors accustomed to a mutual fund or ETF wrapper. Investors need to understand not only the investment strategy, but also the features and risks of the structure, in particular the limited redemption opportunities and potentially higher fees.

Accordingly, asset managers and their distribution partners must provide potential investors with a clear and fulsome explanation of fund strategy and associated risks, redemption requirements, and other information necessary to make an informed investment decision. Factsheets on the strategy are a baseline, but, as with any non-standard vehicle, developing content to educate on the structure and operational complexity is critical. Many intermediaries and advisers lack insight into the mechanics of a closed-end fund (i.e., how it works, differences, benefits, and risks) and thus education and appropriate fund disclosures are key to ensuring the fund is an appropriate investment for the investor. Additionally, advocacy from industry groups, such as the BDAC at ICI, will continue to hasten innovations around improving and automating current operational complexities.



# Top Takeaways

**1** Asset managers who are new to closed-end funds will need to familiarize themselves with their peculiar regulatory standing. Many of the regulatory requirements that apply to private funds, mutual funds, and ETFs do not apply to closed-end funds, and vice-versa.

**2** Closed-end funds allow asset managers to efficiently manage investor redemptions with predetermined liquidity windows and therefore are better suited to hold illiquid or alternative investments that may have longer holding periods.

**3** Asset managers will naturally cultivate success through a commitment to education, patience in the market, and thorough appreciation for the complexities and fees associated with making the product available.

**4** The creation of a retail product by an alternative asset manager allows access to an untapped group of investors. With a previous focus on institutional clients and accredited investors, the vast number of potential investors is enticing.

# ACA Foreside ™

## About ACA Foreside

ACA Group (ACA) is the leading governance, risk, and compliance (GRC) advisor in financial services. We empower our clients to reimagine GRC and protect and grow their business. Our innovative approach integrates advisory, managed services, distribution solutions, and analytics with our ComplianceAlpha® technology platform with the specialized expertise of former regulators and practitioners and our deep understanding of the global regulatory landscape.

We work with asset management firms throughout the world to facilitate compliance and product distribution through legal underwriting, registered representative licensing, and DTCC/NSCC fund sponsorship. We have experience working with all types of pooled investment vehicles such as mutual funds, exchange traded funds (ETFs), alternative products, closed-end interval funds, business development companies (BDCs) and private placements. To learn more about our distribution services, click [here](#).