Closed-End Funds, Interval Funds or BDCs

Summary overview to help in choosing the right structure

Prepared by:

Owen J. Pinkerton
Lindsey Magaro

Morris, Manning & Martin, LLP

Potential Structures

- There are a number of possible structures for sponsors to consider:
  - *Business Development Companies (BDCs)* – investment company regulated under the Investment Company Act of 1940 (1940 Act) primarily designed to invest in private U.S. companies;
  - *Closed-End Funds (Tender Offer Funds)* – investment company registered under the 1940 Act that is not an open-end fund (i.e., mutual fund) and, therefore, typically invests in less liquid securities than open-end funds;
  - *Interval Funds* – type of closed-end fund that is required to offer to repurchase at least 5% of outstanding securities at pre-determined intervals (e.g., quarterly, semi-annually or annually); or
  - *Private Funds* – funds that would be regulated under the 1940 Act, except for exemptions found in Section 3(c) of the 1940 Act. Most common exemptions are 3(c)(1), which permits no more than 100 holders, and 3(c)(7), which is limited to "qualified purchasers."

Threshold Questions

- What will your portfolio of investments look like?
  - ➢ For example, BDCs must have at least 70% of their assets invested in "qualifying assets," which include investments in private, U.S. companies or U.S. companies with market capitalization of less than $250 million, so if foreign securities are a large part of the investment strategy, then a BDC is the wrong structure.
  - ➢ If investments are generally long-term and illiquid, then the repurchase requirements attached to an interval fund may be unfavorable.
  - ➢ If there is a sector or geographic focus in the fund's name, the fund will need to approve a non-fundamental policy to ensure that 80% of the net assets are within such sector or region.

Threshold Questions

- Who are your target investors?
  - If the answer is accredited investors, the only option is a "private BDC," which is a BDC that conducts a private offering. A private BDC is required to register its shares with the SEC, but may conduct a private offering to accredited investors pursuant to Regulation D without being a 3(c)(1) or 3(c)(7) fund.
  - If the answer is retail, then any of closed-end fund, interval fund or BDC is an option. BDCs will be subject to higher suitability standards in certain states (pursuant to state review and NASAA guidelines).
  - If investors are looking for a perpetual-life entity, the liquidity features of an interval fund may be the best fit.
  - The inability of BDCs to be able to offer multiple share classes presents challenges for most BDCs with respect to retirement accounts.

Overview of Key Differences

	Closed-End Fund	Interval Fund	BDC
FINRA Rule 15-02	Manageable because of multiple share classes	Manageable because of lower upfront commissions and multiple share classes	Impediment because no current ability to offer multiple share classes
DoL Fiduciary Rule	Somewhat manageable because upfront commissions limited to 8%	Manageable because of lower upfront commissions	Impediment because upfront commissions limited to 10%
Ability to issue multiple share classes	Yes with exemptive relief from the SEC	Yes with exemptive relief from the SEC	Currently, not permitted
Attractiveness to RIAs	Somewhat depending on investments	More attractive because of guaranteed liquidity	Somewhat depending on investments
Advisory Fees	Management fees and sometimes income incentive fees	Generally, just management fees	Management fees, income incentive fees and capital gains incentive fees
Repurchases	Flexibility – periodic tender offers as approved by the board of directors	Required to repurchase at least 5% of outstanding shares at each interval; shareholder approval required to stop repurchases	Flexibility – periodic tender offers as approved by the board of directors

MORRIS, MANNING & MARTIN, LLP

Overview of Key Differences

	Closed-End Fund	Interval Fund	BDC
Sales Load	Limited to 8% measured at completion of offering (FINRA Rule 5110)	Subject to FINRA Rule 2341, measured at investor level as percentage of offering price; separate limits for upfront fees and ongoing fees	Limited to 10% measured at completion of offering (FINRA Rule 2310)
Disclosure / Transparency	Periodic reports pursuant to Section 30 of the 1940 Act (annual and semi-annual reports, quarterly schedule of investments); less transparency than Exchange Act reports	Periodic reports pursuant to Section 30 of the 1940 Act (annual and semi-annual reports, quarterly schedule of investments); less transparency than Exchange Act reports	Periodic reports under the Exchange Act (10-Ks, 10-Qs, 8-Ks); greater transparency than 1940 Act periodic reports
Asset Coverage Ratio	300%	300%	200%
Blue Sky Requirements	Notice filings to the states; no substantive review	Notice filings to the states; no substantive review	Must be qualified in each jurisdiction; substantive review and compliance with NASAA Omnibus Guidelines
FINRA Filing Requirements	File pursuant to Rule 5110 and pay fees	No filing required pursuant to Rule 2341; no fees	File pursuant to Rule 2310 and pay fees

Need more information?

For more information, please contact us at:

Owen J. Pinkerton
Partner
Morris, Manning & Martin LLP
1401 Eye Street, NW, Suite 600
Washington, DC 20005
(202) 216-4812
opinkerton@mmmlaw.com

Lindsey Magaro
Associate
Morris, Manning & Martin LLP
1600 Atlanta Financial Center
Atlanta, GA 30326
(404) 495-3613
lmagaro@mmmlaw.com