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Fund Alert

A Publication of the Stradley Ronon Investment Management Group

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JANUARY 2018

Stradley Ronon Stevens & Young, LLP
2005 Market Street
Suite 2600
Philadelphia, PA 19103-7018
215.564.8000 Telephone
215.564.8120 Facsimile
www.stradley.com

With other offices in:
Washington, DC
Chicago
New York

House Passes 'Expanding Investment Opportunities Act' – Potential Impact on Closed-End Fund Shelf Offerings

On Jan. 17, 2018, the House of Representatives passed, by a vote of 418-2, the Expanding Investment Opportunities Act (https://www.congress.gov/bill/115th-congress/house-bill/4279/text?r=12) (the Bill).[1] The bipartisan bill, sponsored by Rep. Hollingsworth, R-Ind., and co-sponsored by Reps. Foster, D-Ill., Gottheimer, D-N.J., and Hultgren, R-Ill., requires the Securities and Exchange Commission (SEC) to, within 180 days of the Bill's enactment, propose rules allowing closed-end funds registered under the Investment Company Act of 1940, as amended (the 1940 Act), that are listed on a national securities exchange or that make periodic repurchases pursuant to Rule 23c-3 of the 1940 Act (commonly referred to as "interval funds"), to use securities offering and proxy rules that are currently available to other SEC reporting issuers.[2] Most notably, the House focused on the 2005 Securities Offering Reform rules (https://www.stradley.com/insights/publications/2005/12/public-company-alert-december-2005)[3] (the Securities Offering Rules) applicable to registered offerings of securities. Although the Bill also mentions "proxy rules," it seems that the primary impact of the Bill, should it become law, on closed-end funds involves liberalization of the rules applicable to shelf offerings conducted by closed-end funds.

If the SEC fails to adopt such rules within one year after the Bill's enactment, qualifying closed-end funds would be deemed to be eligible issuers under the Securities Offering Rules, presumably allowing them to adopt new offering and proxy standards on their own. Finally, the Bill explicitly states that it in no way impairs or limits a closed-end fund's ability to use Rule 482, the main rule governing advertisements and marketing communications by closed-end funds, under the Securities Act of 1933, as amended (the 1933 Act).

Background of the Securities Offering Rules

In 2005, the SEC unanimously adopted the Securities Offering Rules to modernize communications, offering and registration procedures under the 1933 Act. The Securities Offering Rules represented the most significant liberalization since the 1980s of the process for conducting registered securities offerings in the United States. The reforms eliminated what the SEC described as "unnecessary and outmoded" restrictions on offerings and provided more timely investment information to investors without mandating delays in the offering process inconsistent with the needs of issuers for timely access to capital. Among other things, the Securities Offering Rules expanded the universe of permissible communications (both written and electronic) by Well-Known Seasoned Issuers (WKSIs)[4] during the offering process, allowing them to quickly capitalize on market opportunities by permitting WKSIs to file "automatic shelf registration statements" that become effective immediately upon filing without SEC staff review. The main justification for allowing WKSIs to utilize a streamlined communication and offering process is that investors have available plenty of detailed and current information concerning these companies. Accordingly, the Bill directs the SEC to consider the availability of information to investors, including what disclosures constitute information adequate to apply the WKSI designation to closed-end funds. We expect the

closed-end fund community to encourage and embrace the application of the Securities Offering Rules to their offerings.

Current Environment for Closed-End Fund Shelf Offerings; How the Bill Would Alter It

The most significant feature of the Bill is the proposed liberalization of the rules governing shelf offerings by closed-end funds. Most closed-end funds engaged in shelf offerings issue shares on a delayed and continuous basis in accordance with Rule 415(a)(1)(x) under the 1933 Act. Under current regulations, such a closed-end fund must file, under Section 8(c) of the 1940 Act, a post-effective amendment to its existing shelf registration statement to bring the fund's financial statements up to date or make other nonmaterial changes.[5] Despite the routine purpose of the amendment, the SEC staff is required to review and declare effective any such post-effective amendment filed to a closed-end fund shelf registration statement.[6] This review may trigger additional SEC staff comments unrelated to the financial statements or nonmaterial changes, which must be addressed by the fund to the staff's satisfaction before the amendment can be declared effective. These mechanics may introduce significant delay and expense into a closed-end fund's shelf offering process.

To combat these constraints, several closed-end fund complexes have successfully secured SEC no-action relief[7] that allows the covered funds to rely on Rule 486(b) of the 1933 Act and file post-effective amendments, which become effective automatically, to an existing shelf registration statement to bring the financial statements up to date and make nonmaterial changes.[8] These amendments to the shelf registration statements are not subject to SEC staff review, which provides these funds with continuously effective shelf registration statements. This exemptive relief allows the covered funds to seize market opportunities to raise additional capital, and reduces time and expenses associated with the shelf offering process.

By requiring the SEC to adopt rules to allow closed-end funds to utilize the Securities Offering Rules, the Bill attempts to achieve the goals, including continuously effective shelf registration statements and automatic effectiveness of amendments, that are currently accomplished by many closed-end funds through no-action relief. Eliminating the need for no-action relief and post-effective amendments filed under Rule 486(b), and the associated costs and burdens, may induce additional closed-end funds to offer shelf-registered shares on a continuous basis, thereby making closed-end funds more liquid, visible and competitive in the market.

Finally, the Bill's "hands off" approach to Rule 482 allows closed-end funds to continue to rely on this important and flexible rule covering the use of advertising and marketing materials in their securities offerings. The Securities Offering Rules cited Rule 482 when explaining why most of those rules were originally inapplicable to closed-end funds. Going forward, the combination of the liberalized and flexible Securities Offering Rules and the continued ability to rely on Rule 482 should modernize and streamline the closed-end fund shelf offering process.

Looking Forward

The Bill was sent (https://www.congress.gov/bill/115th-congress/house-bill/4279/all-actions?overview=closed%20-%20tabs)9 to the Senate on Jan. 18, 2018, where it was referred to the Committee on Banking, Housing and Urban Affairs. Given the current environment on Capitol Hill, it is unclear how much attention the Bill will garner from the Senate. Also, in the event that the Bill becomes law, it is difficult to predict how the SEC would prioritize and implement the rules in the allotted one-year time period. If the SEC fails to finalize these rule changes, and the "dead hand" provision making the Securities Offering Rules and proxy rules "automatically" applicable to closed-end funds kicks in, it may cause uncertainty and confusion in the realm of closed-end fund shelf offerings.

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[1] Expanding Investment Opportunities Act, H.R. 4279, 115th Cong. (2018).

[2] Issuers that are required to file reports with the SEC under Section 13 or Section 15(d) of the Securities Exchange Act of 1934, as amended.

[3] SEC Release No. 33-8591 (July 19, 2005) (Securities Offering Reform Adopting Release).

[4] *Id*. at § 2.

[5] Section 10(a)(1) of the 1933 Act states, in pertinent part, that "a prospectus relating to a security . . . shall contain the information contained in the issuer's registration statement." Section 10(a)(3) of the 1933 Act states that, notwithstanding Section 10(a)(1), "a prospectus [that] is used more than nine months after the effective date of the registration statement must have information as of a date not more than sixteen months prior to such use . . ." (a 10(a)(3) Prospectus). Shelf registration statements filed pursuant to Rule 415(a)(1)(x) are required by Item 34.4(a) of Form N-2 to undertake "to file, during any period in which offers or sales are being made, a post-effective amendment to the registration statement: (1) any prospectus required by Section 10(a)(3) of the 1933 Act."

[6] The SEC staff is not required to review a post-effective amendment filed for the sole purpose of including exhibits to a registration statement.

[7] See, e.g., 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); Calamos Convertible Opportunities and Income Fund, et al., SEC Staff No-Action Letter (Feb. 14, 2011) and Invesco Senior Income Trust, et al., SEC Staff No-Action Letter (Jan. 26, 2017).

[8] Closed-end funds may utilize Rule 486(b) to file post-effective amendments to their existing shelf registration statements to (1) bring the financial statements of the fund up to date under Section 10(a)(3) of the 1933 Act or Rule 3-18 of Regulation S-X; (2) update information required by Item 9.1.c of Form N-2; or (3) make nonmaterial changes that the registrant deems appropriate. Rule 486(b) also imposes conditions that require, among other things, that the post-effective amendment be filed for no purpose other than those stated above and that the registrant make certain representations concerning the purpose for which the amendment is filed.

[9] Expanding Investment Opportunities Act, H.R.4279, 115th Congress (2018), available at https://www.congress.gov/bill/115th-congress/house-bill/4279/all-actions?overview=closed#tabs. (last visited Jan. 23, 2018).

David P. Glatz

Martha D. Frabizo

For more information, contact David P. Glatz at 312.964.3502 or dglatz@stradley.com or Martha D. Frabizo at 312.964.3509 or mfrabizo@stradley.com.