

Chapman Client Alert

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Current Issues Relevant to Our Clients

SEC Amends Rules to Streamline Offerings of Closed-End Funds and Business Development Companies; Increases Periodic Reporting Disclosure

On April 8, 2020, the Securities and Exchange Commission (“SEC”) adopted rule amendments (SEC File Nos. 33–10771; 34–88606; IC–33836) that will allow closed-end funds and business development companies (“BDCs” and, collectively, “affected funds”) the ability to use registration, offering and communications rules that are currently available to publicly-registered operating companies. The rule-making is in response to Congressional mandates included in the Small Business Credit Availability Act and the Economic Growth, Regulatory Relief, and Consumer Protection Act promulgated in 2018. The SEC’s press release said these rule amendments were “designed to better align the modern immediately-effective or automatically effective offering process long available to other types of funds with the structures of the newly eligible funds.” Most of the rule amendments will become effective on August 1, 2020, with certain exceptions and additional transition periods, as discussed further below.

Under the Securities Act of 1933, as amended, eligible affected funds will be allowed to file a short-form registration statement and sell securities “off the shelf.” Affected funds meeting historical public reporting requirements with a public float of \$75 million or more will be able to utilize the shelf registration statement and offering process. Affected funds with a public float of \$700 million or more will be able to qualify as a “well-known seasoned issuer” (“WKSI”) which would allow for a more flexible registration process and greater latitude in communicating with the market. In addition, those affected funds that conduct continuous offerings of securities will be able to avail themselves of Rule 486, which was previously only applicable to closed-end funds that operated as “interval funds.” Rule 486 will allow affected funds to revise registration statements on an immediately-effective basis or on an automatically effective basis a set time after filing. “Interval funds” and certain other exchange traded products (“ETPs”) will also be allowed to register an indefinite number of shares and pay registration fees based on “net issuance” of shares.

The new rules will allow affected funds to satisfy final prospectus delivery requirements by filing prospectuses with the SEC under an “access equals delivery” regime that has been available to operating companies. Affected funds which are currently required to provide new purchasers with a copy of all materials that are incorporated by reference into the registration statement will likewise now be allowed instead of physical delivery to make incorporated materials readily available on a website. Affected funds will also be able to use “free writing prospectuses” and communicate factual business information, forward-looking statements and certain

broker-dealer research reports in the same manner available to publicly registered operating companies. These changes were designed to “reduce regulatory costs while providing more timely information to investors,” according to the SEC.

This increased offering flexibility has a cost, although comparatively minor when weighed against the benefits provided by the new rules. Affected funds that use the short-form “shelf” registration statement will be required to include certain key prospectus disclosures in their annual reports, including the fund’s fee table, share price data, and senior securities table, as well as disclosure of any material unresolved SEC staff comments. Similar to mutual funds, exchange-traded funds (“ETFs”) and BDCs, closed-end funds will also be required to include management’s discussion of fund performance (MDFP) in their annual reports. Affected funds will additionally be subject to structured data requirements and required to tag certain registration statement information, similar to current tagging requirements for mutual funds and ETFs.

Rule 8b-16(b) under the Investment Company Act of 1940, as amended, allows affected funds to forgo an annual registration statement update to the extent that they disclose in their annual reports certain key changes that have occurred during the prior year. The SEC largely adopted as proposed amendments to Rule 8b-16(b) requiring affected funds that rely on this rule to describe in their annual reports changes to their current investment objectives and policies and principal risks in sufficient detail to allow investors to understand each change and how it may affect the fund. For example, to the extent an

affected fund's principal investment objectives, investment policies or principal risks have changed, the fund will be required to describe its objectives, policies or risks before and after the change. Such disclosures must be prefaced with a legend clarifying that the disclosures provide only a summary of certain changes that have occurred in the past year, which may not reflect all of the changes that have occurred since the investor purchased the fund. In addition, any affected funds that rely on Rule 8b-16(b) must disclose in annual reports current investment objectives, investment policies and principal risks, even if there were no changes in the past year. The SEC encourages that these disclosures be presented in accordance with "plain English" principles, tailored to how the fund operates rather than providing generic statements regarding investment policies and risks, and that principal risks be presented in order of importance and not in alphabetical order.

The SEC did not adopt proposed Form 8-K reporting requirements for registered closed-end funds or proposed amendments to Form 8-K (requiring information regarding material changes to investment objectives and material write-downs of significant investments) for any affected funds. Although registered closed-end funds generally will not be mandated to file reports on Form 8-K, affected funds eligible to file a short-form registration statement may voluntarily file information on Form 8-K to incorporate that information into registration statements or to disseminate information under exchange rules.

The new rules will become effective on August 1, 2020, except that the amendments related to registration fee payments by interval closed-end funds and certain ETPs and the

requirement for registered closed-end funds to include MDFP in their annual reports to shareholders become effective on August 1, 2021. In addition, the SEC established a transition period for structured data reporting requirements for financial statements, registration statement information, and prospectus information (August 1, 2022 for affected funds eligible to use a short-form registration statement and February 1, 2023 for other affected funds).

The SEC's press release said these rules were "designed to streamline the registration, offering and investor communications processes for BDCs and registered closed-end funds and will provide important benefits to market participants and investors, including advancing capital formation and modernizing and streamlining disclosures." These rule changes provide significant, meaningful benefits that should be realized by affected funds in efficiencies in both the speed and expense of offering securities to investors. SEC Chairman Jay Clayton, in a statement accompanying the release, said "[i]t is my hope, particularly when many of our small and medium sized businesses are facing profound challenges not of their own making, that these and other modernization efforts will provide those businesses more efficient access to financing."

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