

**INFORMATIONAL**

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**Interval Funds**

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**NASD Adopts Exemption From The Corporate Financing Rule For Interval Funds; Effective June 20, 2000****SUGGESTED ROUTING**

*The Suggested Routing function is meant to aid the reader of this document. Each NASD member firm should consider the appropriate distribution in the context of its own organizational structure.*

- Corporate Finance
- Legal & Compliance
- Mutual Fund
- Registered Representatives

**KEY TOPICS**

- Mutual Funds
- NASD Rule 2710
- NASD Rule 2830
- Underwriting Compensation

**Executive Summary**

NASD Regulation, Inc. (NASD Regulation<sup>SM</sup>) has adopted amendments to National Association of Securities Dealers, Inc. (NASD<sup>®</sup>) Rules 2710 and 2830 to exempt certain closed-end mutual funds that are structured as “interval funds” from the filing requirements, filing fees, and regulations of Rule 2710 and instead to subject them to the Rule 2830, which regulates the distribution and sales charges of open-end funds.<sup>1</sup>

The text of the amendments is included with this *Notice to Members* (see Attachment A). The amendments became effective June 20, 2000.

**Questions/Further Information**

Questions concerning this *Notice to Members* may be directed to Joseph E. Price, Director, Corporate Financing Department, NASD Regulation, at (240) 386-4623.

**Background**

NASD Rule 2710 (Corporate Financing Rule) regulates the underwriting terms and other arrangements of public offerings of securities. Subparagraph (b)(8)(C) of the Corporate Financing Rule provides that offerings of securities of investment companies registered under the Investment Company Act of 1940 (1940 Act) are exempt from the Corporate Financing Rule, unless the offering is of securities of a management company defined as a “closed-end” company in Section 5(a)(2) of the 1940 Act (closed-end funds).<sup>2</sup> Thus, offerings of securities of closed-end funds are subject to the filing requirements, filing fees, and regulations of the Corporate Financing Rule. Continuous offerings of redeemable

securities of open-end investment management companies (open-end funds) are exempt from the Corporate Financing Rule. Instead, members’ receipt of fees in connection with selling shares of open-end funds is regulated under NASD Conduct Rule 2830 (Sales Charge Rule).

The Corporate Financing Rule has long been applied to members’ sales of the securities of closed-end funds on the basis that closed-end fund offerings are structured and marketed in a manner that is more similar to and competitive with corporate securities offerings than open-end funds. At the time the Corporate Financing Rule was adopted, closed-end funds conducted offerings of a fixed number of common shares at specified times; priced their shares periodically; limited sales compensation of broker/dealers to a discount from a fixed-offering price; did not redeem their securities; and generally listed their securities on a securities market.

**Interval Funds**

Certain closed-end funds, commonly known as “interval funds,” have developed a hybrid structure in which they engage in continuous offerings of their securities under Securities and Exchange Commission (SEC or Commission) Rule 415; price their shares daily; pay broker/dealers initial and continuing compensation that meets the limitations in the Sales Charge Rule; do not list their securities on a securities market; and redeem shares by making periodic self-tenders in compliance with Rule 23c-3(b) of the 1940 Act. Rule 23c-3(b) requires that interval funds establish a fundamental policy of making periodic repurchase offers; this policy is then changeable only by a majority

vote of the outstanding voting securities of the company. Because the shares of interval funds are not redeemable on a daily basis, they are classified as “closed-end” under the 1940 Act.

NASD Regulation believes that the distribution of interval fund shares is conducted and financed in a manner more similar to that used by open-end funds than the method used by traditional closed-end funds. Therefore, the calculation of members’ compensation for the distribution of interval fund shares is more properly regulated by the Sales Charge Rule, rather than by the limitations on underwriting compensation in the Corporate Financing Rule.

### **Description Of Amendments**

NASD Regulation has amended the Corporate Financing Rule and the Sales Charge Rule to exempt interval funds from the filing requirements, filing fees, and regulations of the Corporate Financing Rule and instead to subject them to the Sales Charge Rule, which regulates the distribution and sales charges of open-end funds.<sup>3</sup> The amendment to subparagraph (b)(8)(C) of the Corporate Financing Rule provides that closed-end fund offerings are exempt if the fund makes periodic

repurchase offers pursuant to Rule 23c-3(b) and it offers its shares on a continuous basis pursuant to Rule 415(a)(1)(xi) under the Securities Act of 1933. Closed-end funds that do not meet these requirements continue to be subject to the Corporate Financing Rule. The amendment to subparagraphs (d) and (j) of the Sales Charge Rule provide that interval funds are subject to the provisions regulating sales charges and the repurchases of fund securities.

### **Implementation**

The amendments became effective June 20, 2000. Interval funds that previously received a “no objections” opinion from the Corporate Financing Department based upon representations that underwriting compensation would not exceed the guidelines in the Corporate Financing Rule can now rely on the Sales Charge Rule limitations, provided that the Corporate Financing Rule’s compensation limit has not already been met or exceeded. Any interval fund that has reached the applicable compensation limit under the Corporate Financing Rule shall remain subject to the requirements of this Rule until the fund files a post-effective amendment with the Commission registering additional securities.

### **Endnotes**

<sup>1</sup>Securities Exchange Act Release No. 42965 (June 20, 2000); 65 F.R. 39640 (June 27, 2000).

<sup>2</sup>Section 5(a)(1) of the 1940 Act defines “open-end company” as “a management company which is offering for sale or has outstanding any redeemable security for which it is the issuer.” Section 5(a)(2) of the 1940 Act defines “closed-end company” as “any management company other than an open-end company.”

<sup>3</sup>Interval funds are distinguished from other hybrid closed-end funds that make periodic self-tenders in compliance with Rule 13e-4 and Schedule 13E-4 under the Act (“tender offer funds”). Such tender offer funds are not required to establish as a fundamental policy that they will make periodic repurchases, as required by Rule 23c-3(b) under the 1940 Act. The rule change adopted herein would not exempt tender offer funds from the Corporate Financing Rule. However, NASD Regulation will consider individual requests for exemption under the Rule 9600 Series from the requirements of the Corporate Financing Rule for such tender offer funds. See, Exemption granted October 29, 1999 under “Corporate Financing Rule - Rule 2710” at the Exemption Requests Web Page on the NASD Regulation Web Site ([www.nasdr.com/2920.htm](http://www.nasdr.com/2920.htm)).

**ATTACHMENT A****Text Of Amendments**

(Note: New text is underlined; deletions are bracketed.)

**2710. Corporate Financing Rule - Underwriting Terms and Arrangements**

(a) No change

**(b) Filing Requirements**

(1) – (7) No change

**(8) Exempt Offerings**

Notwithstanding the provisions of subparagraph (1) above, the following offerings are exempt from this Rule, Rule 2720, and Rule 2810. Documents and information relating to the following offerings need not be filed for review:

(A) – (B) No change

(C) securities of [investment companies registered under the Investment Company Act of 1940, as amended, except securities of a management company defined as a “closed-end company” in Section 5(a)(2) of that Act] “open-end” investment companies as defined in Section 5(a)(1) of the Investment Company Act of 1940 and securities of any “closed-end” investment company as defined in Section 5(a)(2) of that Act that:

(i) make periodic repurchases offers pursuant to Rule 23c-3(b) under the Investment Company Act of 1940; and

(ii) offers its shares on a continuous basis pursuant to

Rule 415(a)(1)(xi) under the Securities Act of 1933.

(D) – (J) No change

**(9) – (12)** No change

**(c) – (d)** No change

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**2830. Investment Company Securities**

(a) – (c) No change

**(d) Sales Charge**

No member shall offer or sell the shares of any open-end investment company, any closed-end investment company that makes periodic repurchase offers pursuant to Rule 23c-3(b) under the 1940 Act and offers its shares on a continuous basis pursuant to Rule 415(a)(1)(xi) under the Securities Act of 1933, or any “single payment” investment plan issued by a unit investment trust (collectively “investment companies”) registered under the 1940 Act if the sales charges described in the prospectus are excessive. Aggregate sales charges shall be deemed excessive if they do not conform to the following provisions:

(1) – (5) No change

**(e) – (i)** No change

**(j) Repurchase from Dealer**

No member who is a principal underwriter of a security issued by an open-end [management] investment company or a closed-end investment company that makes periodic repurchase offers pursuant to Rule 23c-3(b) under the 1940 Act and offers its shares on a continuous basis pursuant to Rule

415(a)(1)(xi) under the Securities Act of 1933 shall repurchase such security, either as principal or as agent for the issuer, from a dealer acting as principal who is not a party to a sales agreement with a principal underwriter, nor from any investor, unless such dealer or investor is the record owner of the security so tendered for repurchase. No member who is a principal underwriter shall participate in the offering or in the sale of any such security if the issuer voluntarily redeems or repurchases its securities from a dealer acting as principal who is not a party to such a sales agreement nor from any investor, unless such dealer or investor is the record owner of the security so tendered for repurchase. Nothing in this paragraph shall relate to the compulsory redemption of any security upon presentation to the issuer pursuant to the terms of the security.

Nothing in this Rule shall prevent any member, whether or not a party to a sales agreement, from selling any such security for the account of a record owner to the underwriter or issuer at the bid price next quoted by or for the issuer and charging the investor to a reasonable charge for handling the transaction, provided that such member discloses to such record owner that direct redemption of the security can be accomplished by the record owner without incurring such charges.

**(k) – (n)** No change

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