Introduction to Interval Funds

Narrative:

Closed-end interval funds are not a new investment structure but have recently grown in popularity. However, it's important to clearly understand the details and complexities associated with them before considering such a fund. This course is designed to provide you with a comprehensive understanding of interval funds, to include how they compare to other investment companies, potential advantages, performance measures, fees and expenses, financial reports and statutory and regulatory requirements.

This course was created in collaboration with Kevin Vonnahme, Esq. of Mick Law P.C. LLO and as such is the content reference for much of the material information.

Course Overview

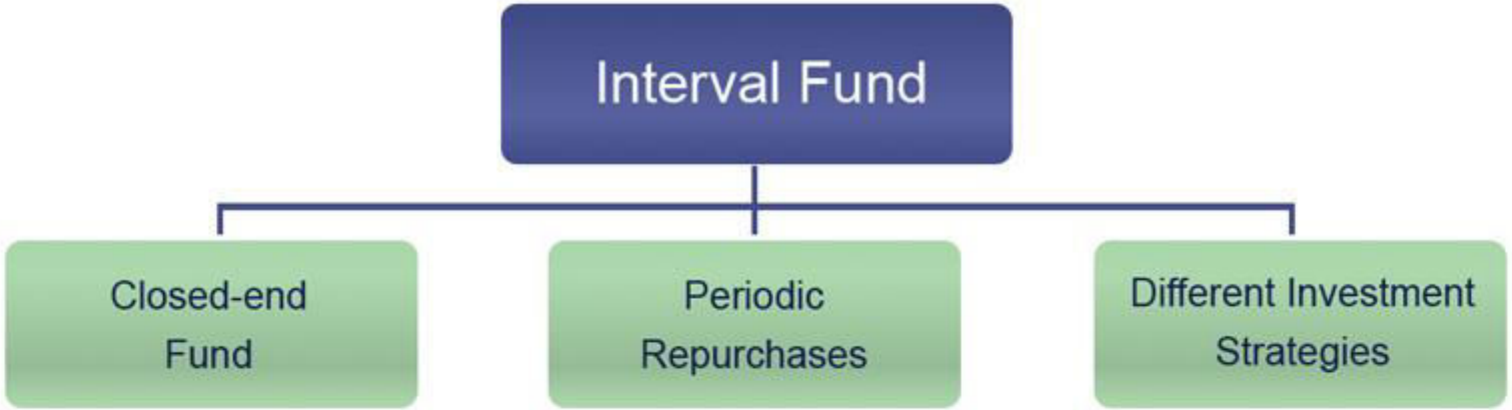
1. Introduction to Interval Funds
2. Comparison with Other Investment Companies
3. Potential Advantages of Non-Listed, Closed-End Structure
4. Performance Measures
5. Fees and Expenses
6. Financial Reports
7. Statutory and Regulatory Requirements
8. Definitions

Narrative:

This is an overview of what the course will cover and to get started, we will begin with an introduction.

Introduction to Interval Funds

What is an Interval Fund?

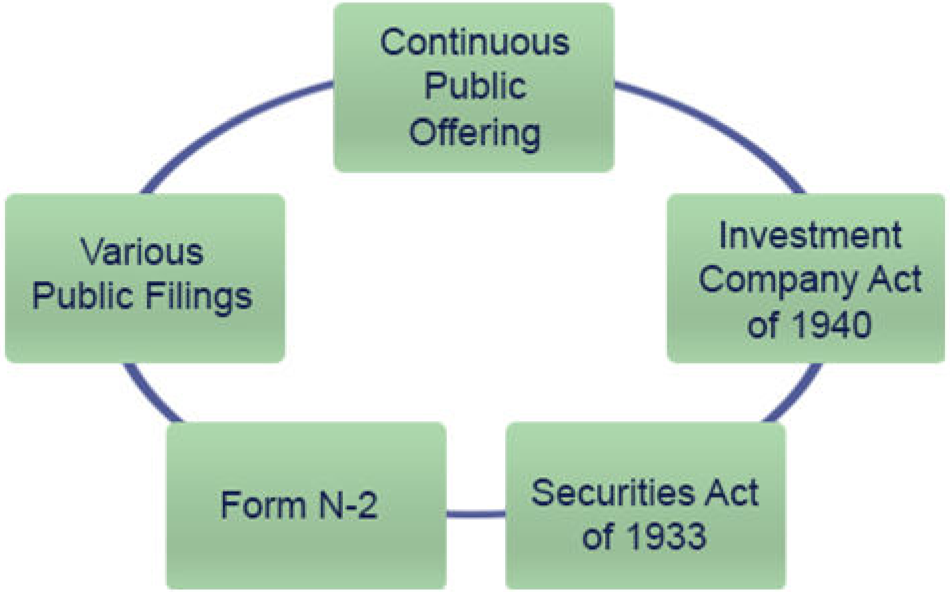


Narrative:

An interval fund is a type of closed-end fund that periodically offers to repurchase a portion of its outstanding shares from shareholders at a price based on NAV. Shareholders are not required to accept these offers and sell their shares back to the fund. There is a common misconception that interval funds can be thought of as a separate asset class. For example, you may hear someone ask how interval funds have performed over the last year. In actuality, an interval fund is merely a type of investment structure or "wrapper."

Interval funds can have vastly different investment strategies. For example, an interval fund can have an investment strategy focused on: credit instruments, energy companies, real estate investments, the healthcare sector, strategic opportunities, a fund of hedge funds strategy, or various other investment types. Thus, it may not be appropriate to lump all interval funds into one asset class for performance comparison, just like you would not categorize all mutual funds into one asset class.

Registration and Reporting Requirements



Narrative:

A non-exchange traded interval fund typically has a continuous public offering. The offering is registered with the SEC under both the 1940 Act and the 1933 Act. When you search EDGAR you will see what appears to be two identical registration statement filings. One filing is for purposes of the 1940 Act and the other is for the 1933 Act. The fund prepares the registration statement on Form N-2 and makes various public filings with the SEC (prospectus, SAI, exhibits, supplements, etc.).

The SEC is the primary regulator of investment companies and investment advisers. Investment companies are generally not regulated by the states, but there may be notice filings or registration fees depending on the state. In contrast, non-traded REITs and BDCs may have to register their offerings with each state.

Registration and Reporting Requirements (Prospectus)

Narrative:

On EDGAR, look for filings under number 497 for the Prospectus and supplements thereto. The graphic shown above is a sample Table of Contents that gives an indication of the type of information included in a prospectus for an interval fund. As you can see from this example, a Prospectus can easily be over 100 pages. This does not include the SAI (which can add another 50+ pages) or financial statements.

If you are used to reviewing prospectuses of REITs or BDCs, you may be looking for a separate “Risk Factors” section. In the case of an interval fund’s prospectus, the risk factors may be included alongside the description of the targeted investment types. In the example above, the risks are described in the section of the Prospectus called “Types of Investments and Related Risks.” Additional risks may be described in the SAI.

Registration and Reporting Requirements (Statement of Additional Information “SAI”)

Narrative:

The SAI is commonly filed with the Prospectus but not always. Here is a sample Table of Contents of an interval fund's SAI.

Registration and Reporting Requirements (Suitability)

No limit on the number of investors

No statutory minimum net worth suitability requirements

Still perform a suitability analysis

Narrative:

Generally, there is no limit on the number of investors that may invest in an interval fund and there are no statutory minimum net worth suitability requirements. As with any other investment, you should still perform a suitability analysis when considering an interval fund investment for a client.

For comparison, here are the general suitability requirements of other certain alternative investment types:

Publicly registered non-listed REITs and BDCs: general suitability guidelines under NASAA: (a) a net worth of at least $250,000; or (b) a net worth of at least $70,000 and a gross annual income of at least $70,000 (with net worth to be calculated exclusive of the value of an investor’s home, home furnishings and automobiles). Each state may have additional suitability requirements (e.g., higher net worth requirements and/or limit investments in these products to 10%).

Private Regulation D offerings: accredited investors.

Registration and Reporting Requirements (Financial Reports)

Certified Shareholder Report (audited)	Semi-Annual Report (unaudited)	Q1 & Q3 Schedule of Investments

Narrative:

Interval funds also have different financial reporting requirements than REITs and BDCs. REITs and BDCs that register under the 1934 Act have ongoing public reporting requirements with the SEC: 10-Qs, 10-Ks (audited), 8-Ks (current reports of material events), proxy statements, etc. Interval funds and other closed-end funds file an annual report called a Certified Shareholder Report (audited) and a semi-annual report on Form N-CSR (unaudited).

Closed-end funds do not have to file 10-Qs. After the first and third quarter, a CEF files a limited report that generally includes only a Schedule of Investments with some explanatory notes. The CEF's quarterly report does not include a balance sheet, statement of operations, statement of changes in net assets or statement of cash flows.

Comparison with Other Investment Companies

Open-End v. Closed-End Investment Companies

Open-End	Closed-End
⇨ Redeemable back to the fund daily at NAV ⇨ Not traded on an exchange ⇨ Liquidity is provided through daily redemptions	⇨ No statutory obligation to redeem ⇨ Listed or non-listed ⇨ Externally managed ⇨ Greater amount of illiquid securities

Narrative:

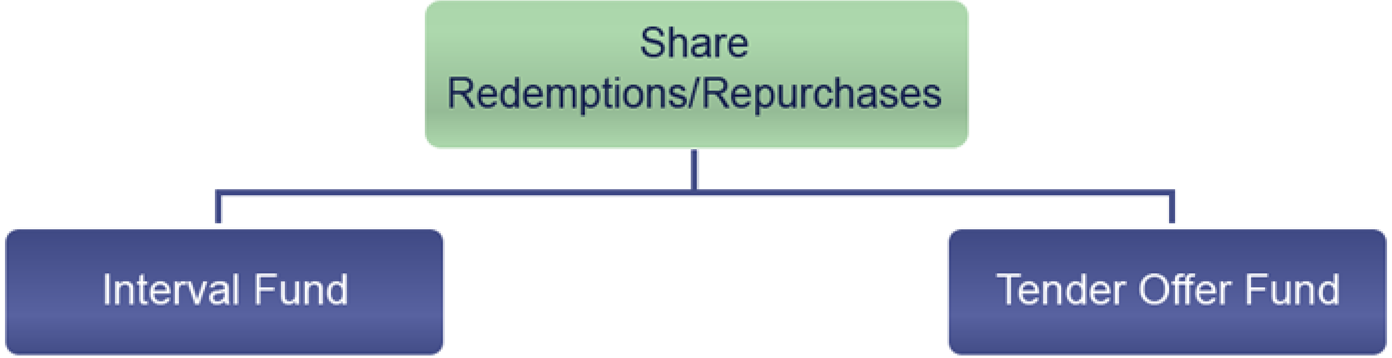
As defined in Section 5(a) of the 1940 Act, "open-end companies" (e.g., mutual funds) have securities that are redeemable. "Redeemable" essentially means that when investors want to sell their shares, they sell them back to the fund at NAV. Open-end funds generally must pay redemption proceeds to a shareholder within seven days of request. In contrast, a closed-end fund generally has no statutory obligation to redeem any shares.

Closed-end funds generally have the following characteristics:

- Closed-end funds may sell a fixed number of shares at one time (in an initial public offering), after which the shares typically trade on a secondary market, such as the NYSE or NASDAQ. Alternatively, a closed-end fund can be non-listed and pursue a continuous offering.
- The price of a closed-end fund's shares that trade on a secondary market is determined by the market and may be greater or less than the shares' NAV. A non-listed closed-end fund's public offering price is adjusted to reflect changes in NAV.
- The investment portfolios of closed-end funds generally are externally managed by investment adviser entities that are registered with the SEC.
- Closed-end funds are generally permitted to invest in a greater amount of "illiquid" securities than are mutual funds. (An "illiquid" security generally is considered to be a security that cannot be sold within seven days at the approximate price used by the fund in determining NAV.) Because of this feature, funds that seek to invest in markets where the securities tend to be more illiquid are typically organized as closed-end funds.
- A closed-end fund is not statutorily required to buy its shares back from investors upon request but the fund may choose to offer repurchases.

Interval funds are "closed-end" investment companies registered under the 1940 Act.

Closed-End Investment Company Share Redemptions/Repurchases



Narrative:

A closed-end fund is not statutorily required to buy its shares back from investors upon request but the fund may choose to offer repurchases. A closed-end fund may offer to repurchase its shares at specified intervals either: (a) as an interval fund or (b) as a tender offer fund.

Interval Fund: in the case of an interval fund, the fund adopts a "fundamental policy" to make periodic repurchase offers, at NAV, of no less than 5% and no more than 25% of the shares outstanding. Most interval funds typically offer to repurchase 5% of shares each quarter. This fundamental policy may only be changed by the affirmative vote of a "majority of the outstanding voting securities" of the Fund*. This is an important distinction from the comparable SRPs commonly adopted by non-listed REITs and BDCs, which are typically subject to potential amendment, suspension or termination at the discretion of the company's board of directors.

Tender Offer Fund: in the case of a tender offer fund, the fund may voluntarily adopt a share repurchase program (similar to a non-listed REIT or BDC). However, since the SRP of a tender offer fund is not a "fundamental policy," the fund has greater ability to amend, suspend or terminate the share repurchases in the Board's discretion.

**See Rule 23c-3(b) of the 1940 Act. Under the 1940 Act, a "majority of the outstanding voting securities" means the lesser of: (a) two-thirds or more of the voting securities present at a meeting if the holders of more than 50% of the RIC's outstanding voting securities are present or represented by proxy; or (b) more than 50% of the RIC's voting securities.*

Closed-End Investment Company Share Redemptions/Repurchases Continued

Example Interval Fund SRP Prospectus Language

The repurchase offers are expected to be made on a quarterly basis. Shareholders will be notified in writing of each quarterly repurchase offer and the date the repurchase offer ends (the "Repurchase Request Deadline"). Shares will be repurchased at the NAV per share determined as of the close of regular trading on the NYSE no later than the 14th day after the Repurchase Request Deadline, or the next business day if the 14th day is not a business day (each a "Repurchase Pricing Date"). The Board, or a committee thereof, in its sole discretion, will determine the number of shares that the fund will offer to repurchase (the "Repurchase Offer Amount") for a given Repurchase Request Deadline. The Repurchase Offer Amount will be no less than 5% and no more than 25% of the total number of shares outstanding on the Repurchase Request Deadline. However, investors should not rely on repurchase offers being made in amounts in excess of 5% of fund assets.

If the tender offer is oversubscribed, the Board may authorize the fund to repurchase an additional amount of shares (e.g., an additional 2% of outstanding shares). If the number of shares tendered for repurchase exceeds the Repurchase Offer Amount, shares will be repurchased on a pro rata basis, not on a first-come, first-served basis. However, the fund may accept all shares tendered (before prorating) in connection with (a) repurchases by shareholders who own less than 100 shares and who tender all of their shares and (b) shares tendered in connection with required minimum distributions from an IRA or other qualified retirement plan.

Narrative:

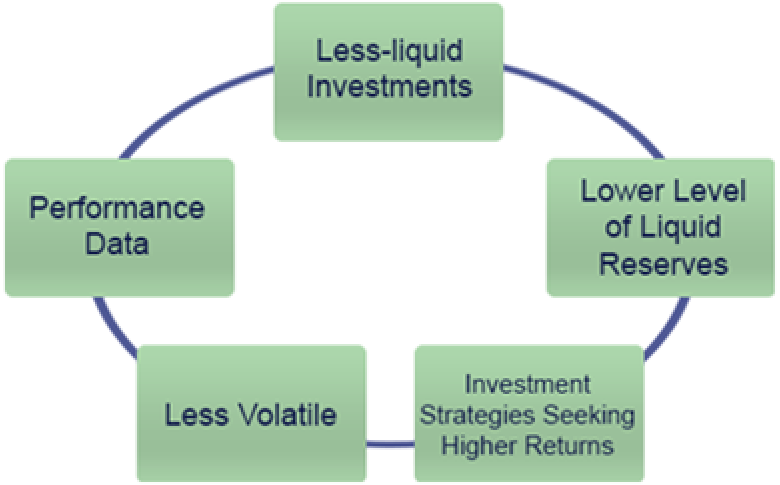
Caution
As a result of the stated limitations, an interval fund's shares should not be described as "liquid."

Takeaway
If an interval fund is underperforming and a lot of investors want to redeem out, it may take an investor several years to fully liquidate the investment since the investor can only redeem out 5% each quarter.
Since the share repurchase policy is a "fundamental policy," the fund may suspend or postpone a Repurchase Offer only with shareholder approval or in certain extraordinary circumstances, i.e.: (a) if making or effecting the repurchase offer would cause the fund to lose its status as an RIC under the Code; (b) for any period during which the NYSE (or any market on which the securities owned by the fund are principally traded) is closed or during which trading in such market is restricted; (c) for any period during which an emergency exists as a result of which disposal by the fund of securities owned by it is not reasonably practicable, or during which it is not reasonably practicable for the fund fairly to determine the value of its net assets; or (d) for such other periods as the SEC may by order permit for the protection of shareholders of the fund*.

*Rule 23c-3(b)(3) of the 1940 Act.

Potential Advantages of Non-Listed, Closed-End Structure

Potential Advantages of Non-Listed, Closed-End Structure



Narrative:

Compared to mutual funds, a closed-end fund can invest in less-liquid investments (e.g., real estate, private debt instruments, venture capital, private equity, etc.) and is not required to hold as high a percentage of liquid assets as "reserves" to satisfy expected daily redemption requests. As a result, a closed-end fund may pursue investment strategies seeking higher returns (i.e., "illiquidity premium").

Liquidity is usually viewed as an advantage. However, there is a contrarian view that illiquidity can be a positive feature in some circumstances (for a portion of an investment portfolio).

Further potential advantages of the non-traded structure:

- Less volatile
- Performance data may be easier to assess without market distortions
  - Compare with traded CEFs that have fluctuating prices and premiums/discounts to NAV: strong performance may lead to being overpriced in the trading market (overpriced compared to NAV).
  - The following is an example as described in a 2016 Morningstar article* on traded closed-end funds.
    - *The most overvalued CEF as of Aug. 3 was also one of the best-performing CEFs in July. After Brexit spooked foreign-equity investors in June, they flooded back into Voya International High Dividend Equity Income (IID), pushing its share price considerably higher than its net asset value. This CEF, the only one in the foreign large-value category, closed the month with a share price gain of 11.85% and a NAV return of 3.31%....*

**http://ibd.morningstar.com/article/article.asp?id=764187&CN=brf295,http://ibd.morningstar.com/archive/archive.asp?inputs=days=14;frmtId=12,%20brf295*

"Run on the Bank" Scenario Under Different Investment Structures

Open-End Mutual Funds

Even if the mutual fund manager knows it is the wrong time to sell, the manager has limited discretion and must sell investment holdings to satisfy daily redemption requests. Widespread liquidations can exacerbate the market sell-off.

Listed Closed-End Fund

In the case of a closed-end fund that is traded on an exchange, the shares may trade at a significant discount to NAV (e.g., in excess of 10%) as investors attempt to sell their shares. While some investors/advisors may welcome volatile markets for buying/arbitrage opportunities, others want to reduce their exposure to volatility.

Non-Listed Closed-End Fund

In the case of a non-listed CEF such as an interval fund, there is a sort of "forced patience" due to the limited redemptions feature (5% per quarter), which limits the ability/temptation of investors to quickly cash out their investments.

Tender Offer Fund or Hedge Fund

The fund may have a voluntary SRP, but the fund manager may have broad discretion to limit or suspend redemptions/withdrawals entirely. Some investors may not be comfortable giving the manager or board of directors this much discretion to shut off redemptions entirely. For an example, think of the movie The Big Short.

Narrative:

What typically happens in a downturn or when markets are volatile? Investors may have a "run on the bank" mentality leading to a market sell-off. There are plenty of studies on the "irrational" behavior of investors. The graphic above shows how this scenario would likely play out under the different investment structures.

Takeaway
Non-listed interval funds are somewhere in the middle of the illiquidity continuum between mutual funds (required daily redemptions) and tender offer funds and hedge funds (can shut off redemptions entirely).

Cautionary Note
The limited redemptions feature of interval funds should be explained and emphasized to investors upfront, prior to making the investment, since an investor will not be happy to learn later down the road that he or she cannot liquidate out of the investment.

Performance Measures

Performance Measures – Total Return

Traditional Calculation	Fund Calculation
Change in NAV plus distributions paid to shareholders during the period.	NAV per share as of the end of the applicable period plus distributions per share declared during the period and divide the total by the NAV per share at the beginning of the period.

Narrative:

Sometimes sponsors or analysts emphasize certain performance measures such as:

Amount of capital raised (AUM)
Distribution rates
Net investment income
Expense ratios
Total return

Many of these performance measures only tell part of the story. We will begin with one of the better of these performance measures for interval funds: "total return." If the shares are publicly traded, the total return would be based on change in trading price rather than NAV.

Pro
Total return factors in both distributions and change in NAV or price.

Con
Total return does not factor in any upfront sales load that may be applicable. For example, interval fund Class A shares are commonly subject to a 5.75% sales load.

A large portion of the change in NAV may be due to unrealized appreciation in the estimated value of portfolio investments or other assets, which is estimated pursuant to valuation policies. There is no guarantee that the estimated value is accurate or that the gain will ultimately be realized.

Performance Measures – Total Return Continued

AS OF AUGUST 31, 2017 (unless otherwise noted)				STOCKHOLDER RETURNS						
				without sales charge, compounded monthly[1]						with sales charge, compounded monthly[2]
	ANNUALIZED DISTRIBUTION RATE[3]	PUBLIC OFFERING PRIZE[4]	CUMULATIVE CASH DISTRIBUTIONS PER SHARE since inception[5]	YTD	1-YEAR	3-YEAR annualized	5-YEAR annualized	SINCE INCEPTION annualized	CUMULATIVE TOTAL RETURN since inception	CUMULATIVE TOTAL RETURN since inception
Business development companies (BDCs)										
FSIC II Inception Date: 6/18/12	8.33%	CLOSED	$3.91	6.9%	13.7%	6.4%	8.6%	8.6%	53.6%	38.2%

Narrative:

In 2015, the Investment Program Association "IPA" established certain performance measures that it recommended for non-listed BDCs. Similar performance measures could potentially be utilized for interval funds.

In addition to the traditional total return measure based on NAV, IPA's standardized guideline for non-listed BDC performance (April 27, 2015) approved two additional performance figures for non-listed BDCs (example shown in the graphic above):

Shareholder Returns (Without Sales Charge):
This measure is similar to the traditional method of calculating total return. Calculated as difference in share price (as influenced by changes in NAV) between the beginning of the period and the redemption price at the end of the period, adjusted for distributions. Excludes selling commissions and dealer manager fees from the opening share price and assumes full participation in DRP (reinvestment of distributions).

Shareholder Returns (With Sales Charge):
Same calculation as above, except it includes selling commissions and dealer manager fees in the share price.

Performance Measures – Amount of Capital Raised (AUM)

Pros

- ⇨ AUM demonstrates whether the sponsor, adviser, or sub-adviser has had success in meeting capital raising goals.
- ⇨ There is a presumption that quality managers will attract investment dollars.
- ⇨ A high capital raise can also mean economies of scale (i.e., costs representing a smaller percentage of net assets).

Cons

- ⇨ New and lesser known sponsors may get overlooked even if they are high-quality.
- ⇨ AUM does not really tell you how the fund has performed or how the investors have fared.

Performance Measures – Distributions

Distribution Rate/Yield

- Calculated as the amount of distributions per share over a period (may be annualized) divided by NAV or share price.
- The distribution rate can potentially be misleading or manipulated.
- Source of distributions need to be considered.

Narrative:

Potentially Misleading
The distribution rate is commonly set as a fixed dollar amount per share but is often described as a percentage of NAV or share price. For example, suppose you have a fund with an NAV per share of $10.00 paying a fixed distribution of $0.15 per share per quarter. The distribution rate would be described as 1.5% per quarter or 6.0% annualized as a percentage of NAV. As a result, a change in the distribution rate can be misleading if the change is based on a change in NAV rather than a change in the distribution dollar amount. For example, what happens to the distribution rate if the NAV increases over the next period to $10.50 per share? The fixed distribution of $0.15 per quarter would be described as an annualized distribution rate of 5.7% as a percentage of NAV, which could give the false appearance that the fund has reduced distributions and is underperforming.

Conversely, if the NAV had declined to $9.50 per share, the fixed distribution of $0.15 per quarter would be described as an annualized distribution rate of 6.3%, which gives the appearance of increasing distributions. Existing investors may not care as long as they continue to receive the $0.15. However, this can be dangerous thinking as there may be concerns about sustainability and an eventual reduction in the distribution amount.

Source of Distributions
Generally, distributions may be paid out of any legally available source, including net investment income, realized gains, borrowings and offering proceeds. What happens if the fund's net income/gains are insufficient to cover the fixed distribution amount? The fund could reduce the distribution amount, but the Board will not want the negative reaction that comes with reducing distributions.

Instead there may be temptation to partially or completely pay the distributions using borrowings or offering proceeds from the fund's equity raise. Historically, this has been a highly criticized common practice with non-listed REITs that have no current NAV calculation. Even large well-known operating companies have decided over the years to borrow money to pay distributions rather than reduce the dividend rate (e.g. auto companies pre-recession and energy companies more recently). However, in the case of RICs and BDCs the requirement to calculate NAV discourages this practice. To the extent distributions exceed earnings/gains ("over distributions"), they are considered a return of capital and over distributions will reduce NAV, which is reflected in the total return calculation

To avoid "over distributions," a number of Sponsors/Advisers waive fees, cover expenses and/or make support payments pursuant to Expense Support Agreements (an example of such an agreement is described later).

Performance Measures – Distributions Takeaways

Be careful when analyzing and describing the distribution rate.

Do not look at distributions in isolation; also look at the total return.

Try to assess if the distribution amount is sustainable over the long term.

Narrative:

Distribution Analysis
Determine if it is a fixed dollar amount or based on changing NAV or share price.

Distribution Sustainability
Look for heavy reliance on expense support payments by the Sponsor/Adviser to cover the distributions. Such an arrangement may be fine if it is temporary (e.g., during the organizational and capital raise stage), but eventually the fund will need to stand on its own and cover distributions with earnings/gains to be sustainable.

Performance Measures – Net Investment Income

Net Investment Income ("NII")

- ⇨ NII measures the amount of income from investments (dividend income, interest income) minus operating expenses.
- ⇨ Excludes gains or losses from sales of investments or unrealized appreciation/depreciation on investments.

Narrative:

Note that "net investment income" is not the same as "net income" reported by operating companies. The comparable measure to "net income" in the fund sector is "net increase in net assets resulting from operations," which will be covered later.

As a result of exclusions noted above, NII may not be all that meaningful especially if the investment strategy is focused on capital appreciation and gains.

Performance Measures – Expense Ratios

Expense Ratios

- ⇨ Expense ratios are useful for comparison with other funds and investment products.
- ⇨ The expense ratio may cover total operating expenses and may be reported gross and net of any expense waivers or support payments by the sponsor/adviser. The Fund may also report specific expense ratios (e.g., management fee as a percentage of average net assets).

Narrative:

Interval funds may have higher expense ratios than other investment products as a result of the investment strategies and active management. As a result, it is important to try to assess whether the performance justifies the fees and expense ratios.

Fees and Expenses

Fees and Expenses - Interval Fund Fees and Expenses Table

Shareholder Transaction Expenses	Class A Shares	Class C Shares	Class Z Shares
Maximum Sales Load (as a percent of offering price)	5.75%	None	None
Contingent Deferred Sales Charge	None	1.00%	None
Annual Expenses (as a percentage of net assets attributable to shares)			
Management Fees	1.67%	1.67%	1.67%
Interest Payments on Borrowed Funds	0.51%	0.51%	0.51%
Other Expenses	2.18%	2.18%	2.18%
Distribution Fee	None	0.75%	None
Shareholder Servicing Fee	0.25%	0.25%	None
Acquired Fund Fees and Expenses	None	None	None
Total Annual Expenses	4.61%	5.36%	4.36%
Fee Waiver and Reimbursement	(1.43)%	(1.18)%	(1.52)%
Total Annual Expenses (after fee waiver and reimbursement)	3.18%	4.18%	2.84%

Narrative:

The above is an example of a Fees and Expenses table of an interval fund at the time of its initial offering in a preliminary prospectus (footnotes omitted). The fees and expenses will be listed in a convenient table in the Prospectus which should allow for easy comparisons with other funds. Note that the estimated annual expenses are required to be presented as a percentage of net assets. Interval fund fees and expenses may vary greatly due to (among other things) different investment strategies. Therefore, it is important to compare funds having similar strategies.

There may be different share classes designed for different distribution channels: broker-dealer, RIA, wirehouse, etc. There is also commonly a separate share class for institutional investors (e.g., Class I Shares) with a high minimum investment threshold. In the example above, the Class Z shares have a high minimum investment requirement and are not subject to a sales load or distribution fees.

Fees and Expenses – Sales Charge

Sales Charge (Upfront Load)

- ⇨ For shares sold through the broker-dealer channel.
- ⇨ In the below example, the maximum sales load is 5.75%, consisting of (i) broker commissions of 5.00% and (ii) distributor fees of 0.75%.

Contingent Deferred Sales Charge ("CDSC") (Back-End Load)

- ⇨ In some cases shares may be subject to an early withdrawal charge.
- ⇨ Typically, if shares are subject to a full upfront sales charge they will not be subject to a CDSC.

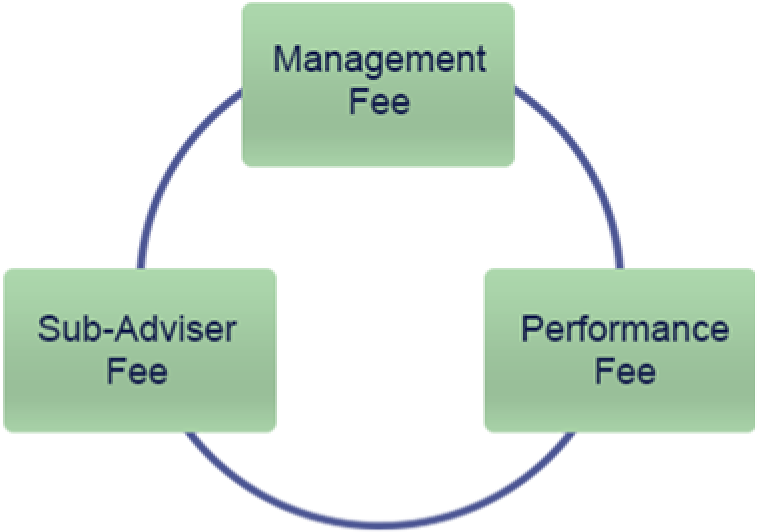
	Class A Shares	Class C Shares	Class Z Shares
Public Offering Price Per Share	$21.22	$20.00	$20.00
Maximum Sales Load as a Percentage of Purchase Amount	5.75%	None	None
Proceeds to the Fund	$20.00	$20.00	$20.00

Narrative:

Interval funds commonly have an upfront sales load. The sales load percentage is based on the gross offering price (i.e., the offering price = NAV + load). Discounts on sales charges may be available for large investments. Other share classes may be "no load" or "load waived" depending on the sales channel and eligibility.

In some cases shares may be subject to an early withdrawal charge. For example, Class C shares redeemed during the first 18 months after their purchase may be charged a CDSC equal to 1.00% of the original purchase price. An early redemption charge discourages frequent trading type strategies.

Fees and Expenses – Advisory Fees



Narrative:

Management Fee
In many cases the investment adviser will receive a base management fee that is calculated based on gross assets (e.g., 1.5% of gross assets), which is inclusive of leverage. If that is the case, the management fee shown in the table will be higher than the contractual rate because the management fee in the table is required to be calculated as a percentage of average net assets, rather than gross assets.

Performance Fee
Some interval funds also pay the investment adviser an incentive fee based on net investment income, subject to a performance hurdle rate. The following is an example:

The Incentive Fee is calculated and payable quarterly in arrears based upon the Fund's "pre-incentive fee net investment income" for the immediately preceding quarter, and is subject to a hurdle rate, expressed as a rate of return on the Fund's adjusted capital, equal to 1.50% per quarter, or an annualized hurdle rate of 6.00%, subject to a "catch-up" feature.

Note that an RIC's investment adviser is generally prohibited from charging an incentive fee based on capital gains or appreciation with certain exceptions. This is an important distinguishing feature of interval funds compared to BDCs and hedge funds, which commonly have a 2%/20% fee structure. One exception would be if every investor in the RIC is a "qualified client," in which case the adviser could receive performance-based compensation based on gains/appreciation. See Rule 205-3 under the Advisers Act. The term "qualified client" includes investors who have at least $1 million of AUM with the adviser and investors who have a net worth of more than $2.1 million.

Sub-Adviser Fee
If a sub-adviser is used, the adviser will typically pay the sub-adviser fee out of the advisory fees (e.g., 50% of the management and incentive fees).

Fees and Expenses – Interest Payments on Borrowed Funds and Other Expenses

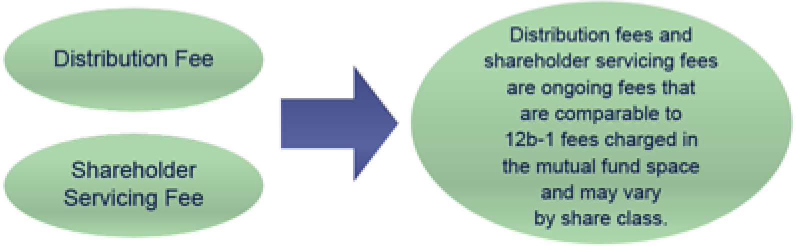
Narrative:

Interest Expenses
Look in the footnotes to the table for the assumed amount of leverage used and annual interest rate. Try to assess whether these assumptions are reasonable. Are the interest rate assumptions consistent with terms of an existing credit facility?

Other Expenses
Other expenses may include accounting, legal, auditing, and administrative fees and expenses and fees payable to the independent directors. Non-independent directors and officers of the fund usually also serve in a similar capacity for the investment adviser or its affiliates and are not directly compensated by the fund for serving as an officer or director of the fund.

Organizational and Offering ("O&O") Expenses
If you have reviewed non-listed REIT and BDC offerings, you may be used to seeing O&O expenses listed as a separate item in a Use of Proceeds table. For interval funds, O&O expenses are commonly included in the "other expenses" category of the Fees and Expenses table or might not be mentioned at all. The Sponsor/Adviser may agree to cover some or all of the O&O expenses.

Fees and Expenses – Distribution Fee and Shareholder Servicing Fee



Narrative:

Although an interval fund is not an open-end investment company, it will generally agree to comply with the terms of Rule 12b-1 in order to obtain SEC permission to have a multi-class structure, CDSCs and distribution and shareholder servicing fees.

Distribution Fee
The distribution fee may be charged in lieu of the upfront sales load and is capped at 0.75%. In our example, the Class C shares are subject to an ongoing distribution fee that will accrue at an annual rate of 0.75% of the average daily net assets of the fund attributable to Class C shares, which will be payable to the distributor/dealer manager on a quarterly basis. Since the distribution fee is an ongoing fee it is included in the Total Annual Expense estimate. In contrast, the upfront sales load is not included in Total Annual Expense. As a result, the Class C shares will likely have a higher annual expense ratio than the Class A shares.

Takeaway
The expected hold period of the investment may be an important consideration when deciding between the two eligible share classes. Check your firm's policy regarding approval of different share classes.

Shareholder Servicing Fee
This fee is capped at 0.25%.

The shareholder serving fee may be intended to compensate financial industry professionals for providing ongoing services in respect of clients with whom they have distributed shares of the fund. Such services may include electronic processing of client orders, electronic fund transfers between clients and the fund, account reconciliations with the fund's transfer agent, facilitation of electronic delivery to clients of fund documentation, monitoring client accounts for back-up withholding and any other special tax reporting obligations, maintenance of books and records with respect to the foregoing and such other information and liaison services as the fund or the adviser may reasonably request.

In some cases an investment adviser may have the discretion to pay from its own resources additional compensation to brokers or dealers in connection with the sale and distribution of fund shares. Check the Prospectus in the section called "Plan of Distribution" to see if this is disclosed.

Caution
The receipt of "Additional Compensation" by a selling broker or dealer may create potential conflicts of interest between an investor and its broker or dealer who is recommending the fund over other potential investments. Any such conflicts of interest should be properly disclosed to clients as applicable (e.g., in Form ADV). Review your firm's policy and any FINRA limitations as applicable.

Fees and Expenses – Acquired Fund Fees and Expenses ("AFFE")

Acquired Fund Fees and Expenses

The indirect costs of investing in other investment companies/funds.

Narrative:

These indirect costs may include performance fees paid to the acquired fund's adviser or its affiliates. AFFE may be relatively high in a fund-of-funds strategy compared to other interval funds.

Note that if a fund invests in operating companies, the underlying company expenses will not show up in AFFE since an operating company is not considered an investment company/fund. In our example, the interval fund may invest in REITs and the underlying REIT expenses are not included in AFFE since a REIT is not considered an investment company/fund.

Takeaway

AFFE is required to be disclosed but is not an actual direct expense of the fund. Some people have criticized the requirement to disclose AFFE since these costs are not directly paid by the fund. By analogy, if a fund invests in operating companies such as Amazon, Apple, or Ford, the fund doesn't have to list those company's operating expenses even though they are indirect costs.

Fees and Expenses – Total Annual Expenses

Total Annual Expenses

May not correlate exactly to the expense ratio in the fund's financial highlights portion of the financial statements because the financial statements include only the direct operating expenses incurred by the fund and do not include indirect costs like AFFE which are required to be reported in the Fees and Expenses table.

Narrative:

Total annual expenses may be reported gross and net of expense waivers and support payments if an Expense Limitation Agreement is applicable.

Fees and Expenses – Expense Limitation Agreements

Expense Limitation Agreements

In many cases an interval fund may enter into an expense limitation agreement ("ELA") with the investment adviser or sponsor, particularly if the fund is in an early stage of development. These agreements may vary by terms, but the adviser will typically agree to waive fees and/or absorb certain expenses of the fund to the extent they exceed a certain amount.

Narrative:

In our example, the adviser agreed to waive its fees and to pay or absorb the "ordinary operating expenses" of the fund to the extent that they exceed a certain percentage of the fund's average "daily gross assets," i.e., 2.0% per annum for Class A shares, 2.75% per annum for Class C shares and 1.75% per annum for Class Z shares (the "Expense Limitation")*.

The fund will typically have a conditional obligation to repay the adviser in the amount of any fees waived and expenses paid or absorbed, subject to the limitations that: (1) the reimbursement for fees and expenses will be made only if payable within three years; and (2) the reimbursement may not be made if it would cause the Expense Limitation at such time to be exceeded. In some cases, the recoupment of such amounts by the adviser may also be conditional on the fund maintaining the same distribution rate to shareholders in effect at the time the expenses were paid by the adviser.

The typical ELA has a one-year term, subject to automatic renewal unless terminated by either party upon proper notice.

Takeaway
The adviser's commitment to the fund and its ability and willingness to continue making expense support payments and/or fee waivers may be an important consideration. This may be especially true for a new fund that has not reached sufficient scale to keep its operating expenses in check without the adviser's support.

**For these purposes, (i) daily gross assets means total assets less any non-leverage liabilities and (ii) "ordinary operating expenses" includes O&O expenses but excludes interest, dividend expenses on short sales, brokerage commissions, AFFE, taxes and extraordinary expenses.*

Financial Reports

Financial Reports – Annual Report, Semi-Annual Report and Form N-Q

Annual Report	Semi-Annual Report	Quarterly Reports on Form N-Q/N-PORT
Includes audited financial statements for the year, similar to a 10-K.	Contains similar information as the annual report but the financial statements are unaudited. Filed after the 2nd quarter of the fiscal year.	Contains a schedule of investments and explanatory notes but is unaudited. Filed after the 1st and 3rd quarter of the fiscal year

Narrative:

Closed-end funds file an annual report (called a Certified Shareholder Report) and semi-annual report on Form N-CSR. These reports are provided to shareholders and filed with the SEC and are available on EDGAR. There are also limited quarterly reports. In each financial report, an RIC is required to include a Schedule of Investments. As a result, there is often greater transparency than comparable private funds (e.g., hedge funds).

The quarterly reports do not contain a balance sheet, statement of operations, financial highlights, etc.

Takeaway
Quarterly performance data (e.g., total return) may not be available.

Pursuant to recent modernization rules Form N-Q will be replaced by Form N-PORT. Under the new Form N-PORT, the fund will still publicly report the portfolio holdings after the 1st and 3rd quarter (within 60 days of quarter-end). In addition, the fund will also file monthly portfolio information with the SEC, which information may be kept confidential, i.e., the fund does not need to disclose the monthly information to the public.

Financial Reports – Schedule of Investments

Schedule of Investments

Lists investment holdings by various categories
(e.g., various debt instruments, preferred equity, common equity, etc.).

Portfolio Company	Industry	Number of Shares	Cost	Fair Value
XYZ Energy, Inc.	Midstream	10,000	$ 100,000	$ 102,000

Narrative:

The Schedule of Investments also names the individual portfolio companies. The fair value is determined or estimated as of the end of the period in accordance with the fund's valuation policies.

Things to look for in the Schedule of Investments:

- Are the investment holdings consistent with the intended asset allocations described in the fund's investment strategy?
- Are there any concentrations in any single investment, industry, geographic region, etc.?
- Are there any debt investments in default (non-accrual status)?
- Any other underperforming investments (fair value estimate significantly below cost)?

Financial Reports – Balance Sheet

Balance Sheet

All of the fund's investments are usually included under one main category called "Investments" since the Schedule of Investments contains the investment details.

	June 30,2017
Assets	
Investments, at fair value (amortized cost - $12,000)	$12,133
Cash	1,000

Narrative:

Here are some items to look for on the balance sheet.

Assets
What portion of total assets is comprised of investments, cash, and other assets? High cash holdings may indicate the fund is having trouble finding suitable investments. Are there sufficient liquid assets to satisfy potential quarterly redemptions? Borrowing capacity may also be available to satisfy redemptions.

Liabilities
Includes amount of debt, payables, accrued expenses, and other liabilities (may have liabilities related to derivatives). Liabilities of investment funds may be relatively low compared to operating companies.

Net Assets
"Net assets" is fund lingo for total equity. Assets minus liabilities = net assets. Divide net assets by shares outstanding to get NAV per share. NAV may vary slightly by share class due to different fees, such as ongoing distribution fees, shareholder servicing fees, etc. Has NAV improved since last period? By how much? The Statement of Changes in Net Assets should list the factors causing the change in NAV.

Financial Reports – Statement of Changes in Net Assets

Statement of Changes in Net Assets

Details the change between the current and prior period for net asset balances.

Narrative:

Here are some basic items you might see.

Net assets beginning of period

Add:
Net increase (decrease) in net assets resulting from operations for the period

- Net investment income
- Realized gains
- Unrealized appreciation on investments

Capital share transactions

- Proceeds from issuance of shares

Less:

- Distributions paid to shareholders
- Share repurchases/redemptions

Net assets end of period

Financial Reports – Statement of Operations

Statement of Operations

Summarizes revenues and expenses over the entire reporting period.

Investment income	Other general and administrative expenses
Dividend income	Total operating expenses
Interest income	Less: Expense reimbursement from sponsor
Total investment income	Net operating expenses
Operating expenses	Net investment income (loss)
Management fees	**Realized and unrealized gain/loss**
Administrative services expenses	Net realized gain (loss) on investments
Accounting and administrative fees	Net realized gain (loss) on foreign currency
Interest expense	Net change in unrealized appreciation (depreciation) on investments
Professional fees	Total net realized gain (loss) and unrealized appreciation (depreciation)
Offering costs	**Net increase (decrease) in net assets resulting from operations**

Narrative:

Note the item below total operating expense called “Less: Expense reimbursement from sponsor”. This relates to an Expense Limitation Agreement.

Statement of Cash Flows

Summarizes cash transactions and includes net cash flows from operating activities and net cash flows from financing activities.

Financial Reports – Financial Highlights and Explanatory Notes

Financial Highlights

The financial highlights might be covered either in a separate financial statement at the beginning or as an explanatory note. This is where you can find total return and other performance measures.

Explanatory Notes

Always review the notes since important details or red flags may be buried in them.

Narrative:

Total Return

- Change in net assets plus distributions.
- Assumes distributions are reinvested.
- Does not factor in initial sales charge or CDSC (early redemption fee).

Expense Ratios

- Gross operating expenses.
- May also show ratio net of expense waivers/support payments.

Portfolio Turnover Rate

Statutory and Regulatory Requirements

Statutory and Regulatory Considerations – Diversification

Diversified v. Non-Diversified under the 1940 Act

An interval fund is allowed to have greater concentration in investments than a diversified investment company such as a mutual fund. However, a fund that is "non-diversified" under the 1940 Act must still meet certain diversification requirements under the Code in order to receive favorable pass-through tax treatment.

Diversification Tests under the Code

At least half of an interval fund's assets must be held in safe and/or diversified holdings. The other half may be concentrated in a small number of investments subject to the 25% limit and the 1940 Act limits on investments in other investment companies.

Narrative:

Diversified v. Non-Diversified under the 1940 Act
An RIC can be designated as either "diversified" or "non-diversified." As defined in Section 5(b) of the 1940 Act, a "diversified company" has at least 75% of its total assets in one or more of the following categories: (i) cash and cash items; (ii) government securities; (iii) securities of other investment companies; and (iv) other securities, which are limited with respect to any single issuer to 5% of the RIC's total assets and 10% of the voting securities of such issuer. Interval funds and other closed-end funds are typically designated as "non-diversified" investment companies.

Diversification Tests under the Code
To receive pass-through tax treatment, an RIC must, among other things, diversify its holdings so that at the end of each quarter of the taxable year:

- Diversified 50% basket: at least 50% of the value of its assets consist of cash, cash equivalents, U.S. government securities, securities of other RICs and other securities if such other securities of any one issuer do not represent more than 5% of the value of the RIC's assets or more than 10% of the outstanding voting securities of any one issuer; and
- 25% limit on investments in any single company: other than U.S. government securities or securities of other RICs, no more than 25% of the value of the RIC's assets is invest ed in the securities of either: (i) a single issuer; (ii) two or more issuers controlled by the RIC and engaged in the same or similar or related trades or businesses; or (iii) one or more "qualified publicly traded partnerships" (as defined in the Code).

There are additional requirements under the Code, which will be covered later.

Statutory and Regulatory Considerations – 1940 Act Limits on Investment in Other Investment Companies

Pursuant to Section 12 of the 1940 Act, an RIC faces restrictions on investments in other investment companies. Essentially, an investment company cannot:

- Own more than 3% of another investment company's voting stock;
- Have more than 5% of its total assets in a single investment company's securities; or
- Have more than 10% of its total assets in any number of investment companies' securities.

Narrative:

These restrictions are intended to prevent pyramiding schemes in which individuals could use a relatively small amount of money to acquire control of a fund and use the fund's assets to acquire control of a second fund, which, in turn, could use that fund's assets to acquire control of a third fund, and so on.

Section 12(d) imposes additional restrictions on an RIC purchasing securities issued by an insurance company, broker, dealer or investment adviser.

Statutory and Regulatory Considerations – Restrictions on Transactions with Affiliates

The 1940 Act imposes restrictions on certain transactions with affiliates.

These restrictions are important safeguards designed to protect investors. Comparable safeguards may not be in place for other investment structures such as REITs, private equity, etc.

Narrative:

Under Section 17(a) of the 1940 Act, affiliates, promoters, principal underwriters and any of their affiliates (i.e., affiliates of affiliates or second tier affiliates) are generally prohibited from selling to, purchasing from, borrowing from, or loaning to the RIC.

Under Section 17(d) and (e), there are restrictions on such parties effecting joint transactions with the RIC and limits on commissions that affiliates may receive when acting as a broker in connection with sales to or by the RIC.

Accordingly, as an RIC, the fund will generally be limited in its ability to invest in any portfolio company in which its investment adviser or any of its affiliates currently has an investment or to make any co-investments with the investment adviser or its affiliates without permission from the SEC.

An investment adviser may apply for an exemptive relief order from the SEC to permit co-investment by various affiliated funds, subject to certain conditions designed to ensure fairness to each fund.

Statutory and Regulatory Considerations – Asset Coverage (Leverage)

33% Leverage Limit

Generally, under Section 18(a) of the 1940 Act, a closed-end RIC may not issue senior securities (e.g. bonds or preferred stock) unless the RIC has an asset coverage ratio* of at least 300% (for senior debt securities) or 200% (for preferred stock) immediately after the issuance of the senior security.

Narrative:

In other words, an RIC can use up to 33 1/3% leverage (1:2 debt-to-equity ratio) of the RIC's total assets. Typically, an interval fund's leverage, if any, will take the form of borrowings and/or derivatives rather than the issuance of bonds or preferred stock.

Some interval funds use 0% leverage depending on the investment strategy. Many interval funds that use leverage will limit their target leverage ratio to 25% to avoid inadvertently exceeding the limit. Borrowings may also be used to pay redemptions if there is a shortage of liquid assets.

Comparison with other types of companies that can use greater leverage than 33%:

- BDCs: 200% asset coverage, or 50% leverage (1:1 debt-to-equity)
- REITs: NASAA REIT guidelines allow REITs to borrow up to 300% of "net assets" (as defined by the guidelines (3:1 debt to net assets, or approximately 75% leverage) or greater leverage if approved by independent directors). "Statement of Policy Regarding Real Estate Investment Trusts" as revised and adopted by the North American Securities Administrators Association membership on May 7, 2007.
- Banks, hedge funds, private equity funds and various other entities may use higher leverage.

Caution
Although an interval fund may have a relatively low leverage ratio at the fund level, it may be indirectly exposed to high leverage as a result of the fund’s investments in underlying portfolio companies. For example, an interval fund may have zero leverage at the fund level but invest in highly leveraged hedge funds, PE funds, real estate companies, etc.

**"Asset coverage" is defined in Section 18(h). For a class of senior debt securities (i.e., bonds, debentures, notes, and similar instruments), "asset coverage" means the ratio of total assets (less liabilities and debt not represented by senior securities) to the aggregate amount of senior debt securities. For preferred stock, "asset coverage" means the ratio of total assets (less liabilities and debt not represented by senior securities) to the aggregate amount of senior debt securities plus the aggregate of any involuntary liquidation preference of such class of preferred stock.*

Statutory and Regulatory Considerations – Derivatives

Derivatives May Count Towards Leverage Limitation

For purposes of the asset coverage test, the use of derivative instruments with leverage embedded in them and similar "uncovered" transactions may count towards the leverage limitation. Examples: options, short selling, reverse repurchase agreements, swaps, futures and forward contracts.

Narrative:

Proposed Rule 18f-4
On December 11, 2015, the SEC proposed a new exemptive rule, Rule 18f-4, relating to the use of derivatives by investment companies, including mutual funds, ETFs, closed-end funds and BDCs. The proposed rule has not yet been adopted.

The proposed rule (if adopted as proposed) would permit such investment companies to enter into derivatives transactions (forwards, futures, swaps, options, etc.) and financial commitment transactions (e.g., reverse repurchase agreements and short sales) notwithstanding the prohibitions and restrictions on the issuance of senior securities under Section 18 of the 1940 Act (i.e., the asset coverage requirements), provided that, such investment companies meet certain conditions. Among other things:

- Comply with certain portfolio limitations (i.e., the rule would limit a fund's aggregate derivatives exposure to either 150% of the fund's net assets or up to 300% of the fund's net assets provided that the fund satisfies a risk-based test based on value-at-risk);
- Maintain an amount of assets to enable the fund to meet its obligations and segregate certain assets (generally cash and cash equivalents); and
- Establish a derivatives risk management program if the fund's exposure reaches a certain threshold.

Statutory and Regulatory Considerations – Restrictions on Discount Sales and Repurchases

Sales

⇨ Under Section 23 of the 1940 Act, a closed-end RIC generally cannot sell its common stock at a price below the current NAV of such stock (exclusive of any distributing commission or discount) except:

- In an offering to holders of its capital stock;
- With the consent of a majority of common stockholders;
- Upon conversion of a convertible security;
- Upon the exercise of warrants; or
- Under such other circumstances as the SEC may permit.

Repurchases

⇨ Under Rule 23c-3(b)(1), a closed-end RIC may make common stock repurchases only at the NAV determined on the repurchase pricing date (but the RIC may deduct a repurchase fee not to exceed 2% of the proceeds).

⇨ Further, the RIC may not condition the entire repurchase offer upon the tender of any minimum amount of shares but may place conditions on individual tenders, for example requiring a shareholder tender at no less than a defined percentage of his or her shares.

Statutory and Regulatory Considerations – Independent Directors

Under Section 10 of the 1940 Act, an RIC is required to have a board of directors/trustees with at least 40% of its members being independent, i.e., not “interested persons” as defined in Section 2(a)(19) of the 1940 Act.

Narrative:

The definition of "Interested person" covers an extensive array of affiliates, family members and other relationships. Questionnaires are commonly used to determine if an individual qualifies as an independent director.

In addition to the 40% requirement, a number of SEC rules require an RIC to have independent directors make up at least a majority or super-majority (e.g., 75% or 2/3) of the Board in order to engage in certain activities*. This includes operating as an interval fund under Rule 23c-3.

In addition, a majority of independent directors must:

- Approve contracts with the investment adviser and principal underwriter;
- Approve the compliance policies and procedures (for securities laws) of the company and its investment advisor, principal underwriter, administrator and transfer agent;
- Approve the codes of ethics of the company, the investment adviser and the principal underwriter;
- Approve the designation, compensation and removal of the chief compliance officer;
- Select the public accountant;
- Select and nominate individuals to fill independent director vacancies resulting from the assignment of an advisory contract;
- Approve and oversee transactions with affiliates; and
- Set the form and amount of the fidelity bond.

**17 C.F.R. §270.0–1(a)(7)*

Statutory and Regulatory Considerations – Operational Considerations

Internal v. External Management

- An RIC may be internally managed or externally managed by a registered investment adviser (and in many cases a sub-adviser as well).
- An investment adviser serves pursuant to an advisory agreement with the fund and is subject to the direction and oversight of the Board.
- A sub-adviser may serve pursuant to a sub-advisory agreement with the investment adviser and the fund and is subject to the direction and oversight of the investment adviser.

Fees

- An interval fund typically pays its investment adviser a base management fee based on a percentage of gross or net assets.
- Interval funds may also pay the investment adviser an incentive fee based on pre-incentive fee net investment income (PIF-NII), which is usually subject to a hurdle rate (preferred return), with a catchup feature.
- Unlike BDCs, interval funds generally do not pay an incentive fee on capital gains.
- If a sub-adviser is used, the sub-adviser will be paid a sub-adviser fee by the investment adviser (commonly a sub-adviser will receive half the advisory fees).

Statutory and Regulatory Considerations – Operational Considerations Continued

Indemnification Restrictions | Valuation of Assets | Fiduciary Duty and Code of Ethics | Fidelity Bond

Narrative:

Indemnification Restrictions
An RIC is prohibited from protecting any director, officer, investment advisor or principal underwriter against any liability to the company or to its security holders arising from willful misfeasance, bad faith, gross negligence or reckless disregard of such person's duties.

Valuation of Assets
An RIC's Board is required to value portfolio assets on at least a quarterly basis in connection with filing certain periodic reports. Assets must be valued on the basis of market value if available. In the absence of a readily ascertainable market value for an asset, the Board must in good faith determine the "fair value."

- For example, an RIC may adopt valuation policies that are designed to comply with the Accounting Standards Codification ("ASC") Topic 820, Fair Value Measurements and Disclosures, issued by Financial Accounting Standards Board ("FASB"), which defines fair value, establishes a framework for measuring fair value in accordance with GAAP and expands disclosures about fair value measurements. ASC Topic 820 defines fair value as the price that would be received from the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.
- ASC Topic 820 also establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include: Level 1, defined as observa ble inputs such as quoted prices in active markets; Level 2, which includes inputs such as quoted prices for similar securities in active markets and quoted prices for iden tical securities where there is little or no activity in the market; and Level 3, defined as unobservable inputs for which little or no market data exists, requiring an entity to develop its own assumptions. RICs may use the assistance of third party valuation firms for "Level 3" assets.

Fiduciary Duty and Code of Ethics
Officers and directors/trustees of the RIC and the investment adviser are subject to general fiduciary duties with respect to the conduct of their duties. The RIC and the investment adviser must adopt a code of ethics and institute procedures reasonably necessary to ensure that employees and certain affiliates adhere to the code.

Fidelity Bond
An RIC must provide and maintain a bond issued by a reputable fidelity insurance company to protect the RIC against larceny and embezzlement. The fidelity bond must cover each officer and employee with access to securities and funds of the RIC, with the required coverage tied to the amount of the RIC's assets. E.g., a $1.5 million fidelity bond is required for an RIC with gross assets of $1.5 billion to $2.0 billion. See Rule 17g-1.

Statutory and Regulatory Considerations – Tax Treatment

For U.S. federal income tax purposes, an investment company may elect to be treated as a regulated investment company under Subchapter M of the Code.

As an RIC, the company generally will not have to pay corporate-level federal income taxes on net ordinary income or capital gains that are distributed to shareholders.

Cash distributions by an RIC generally are taxable to U.S. investors as ordinary income or capital gains.

The fund will send a Form 1099-DIV statement to shareholders identifying the sources of the distributions for U.S. federal income tax purposes.

Narrative:

To qualify and maintain qualification as an RIC for federal income tax purposes, the company must, among other things:

- Distribute to shareholders, for each taxable year, at least 90% of its “investment company taxable income” ("ICTI"), which is generally net ordinary income plus the excess, if any, of realized net short-term capital gain over realized net long-term capital loss (the "Annual Distribution Requirement");
- Be registered as a management investment company under the 1940 Act at all times during each taxable year;
- Derive in each taxable year at least 90% of gross income from: dividends, interest and payments with respect to certain securities, loans, gains from the sale of stock, securities or foreign currencies, net income derived from “qualified publicly traded partnerships” (as defined in the Code) or other income derived with respect to its busi ness of investing in such stock or securities (the "90% Income Test"); and
- Diversify holdings (the "Asset Diversification Test") so that at the end of each quarter of the taxable year:
  - At least 50% of the value of its assets consist of cash, cash equivalents, U.S. government securities, securities of other RICs, and other securities if such other securi ties of any one issuer do not represent more than 5% of the value of the company’s assets or more than 10% of the outstanding voting securities of any one issuer; and
  - Other than U.S. government securities or securities of other RICs, no more than 25% of the value of the company’s assets is invested in the securities of either: (i) a single issuer; (ii) two or more issuers controlled by the company and engaged in the same or similar or related trades or businesses; or (iii) one or more qualified pub licly traded partnerships.
- Even if the company qualifies as an RIC, it will generally be subject to corporate-level federal income tax on undistributed taxable income (if any), and it could be subject to federal excise, state, local and foreign taxes.
- The RIC will be subject to a 4% nondeductible federal excise tax on certain undistributed income as an RIC unless it distributes in a timely manner an amount at least equal to the sum of: (i) 98% of net ordinary income for the calendar year, (ii) 98.2% of net capital gains for the one-year period ending October 31 of that calendar year, and (iii) any net ordinary income and net capital gains recognized, but not distributed, in preceding years and on which the company paid no federal income tax (the "Excise Tax Avoidance Requirement").

Statistical and Regulatory Considerations – ERISA Considerations

Interval funds can accept investments from IRAs, 401(k) and other retirement and employee benefit plans.

Generally there are no concerns about UBTI, but check for disclosures about investments in REMICs and/or TMP and other potential UBTI as applicable.

Narrative:

Plan Assets
Under current ERISA law and regulations, an RIC's shares will not be treated as "plan assets" of a benefit plan subject to ERISA and/or Section 4975 of the Code that purchases shares.

UBTI
Generally, an investment in shares of an RIC is not expected to generate unrelated business taxable income. The RIC serves to "block" (that is, prevent the attribution to shareholders of) UBTI from being realized by certain tax-exempt shareholders (including, among others, IRAs, 401(k) accounts, Keogh plans, pension plans and certain charitable entities). There might be an exception if a tax-exempt investor borrows funds to purchase the shares. In that case, a portion of the RIC's dividends and capital gains could be treated as debt-financed income and therefore UBTI. A tax-exempt shareholder may also recognize UBTI if the RIC were to recognize "excess inclusion income" derived from direct or indirect investments in residual interests in real estate mortgage investment conduits (REMICs) or taxable mortgage pools (TMPs).

Statutory and Regulatory Considerations – RECAP

As an RIC, an interval fund will be subject to numerous legal and regulatory provisions designed to protect investors, including:

- ⇨ Independent director requirements,
- ⇨ Restrictions on transactions with affiliates,
- ⇨ Asset coverage ratios (i.e., limitations on leverage),
- ⇨ Diversification requirements,
- ⇨ Annual distribution requirements,
- ⇨ Limitations on fees,
- ⇨ Portfolio valuation (NAV) requirements, and
- ⇨ Maintaining compliance policies, codes of ethics and a fidelity bond to provide insurance against larceny and embezzlement.

Narrative:

Satisfaction of these requirements will enable the fund to receive favorable "pass-through" tax treatment, whereby the fund generally will not have to pay federal corporate-level income tax on any income distributed to shareholders from earnings and profits. Distributions will generally be taxable to U.S. shareholders as either ordinary income or capital gain. Shareholders receive a Form 1099-DIV identifying the sources of the distributions for U.S. federal income tax purposes.

Definitions

Definitions

1933 Act:	Securities Act of 1933, as amended
1934 Act:	Securities Exchange Act of 1934, as amended
1940 Act:	Investment Company Act of 1940, as amended
Advisers Act:	Investment Advisers Act of 1940, as amended
Affiliate:	"Affiliated person" is defined in section 2(a)(3) of the 1940 Act and essentially means (A) a 5% shareholder of such other person; (B) an entity 5% owned by such other person; (C) a person controlling, controlled by or under common control with such other person; (D) any director, officer, partner, copartner or employee of such other person; (E) the investment adviser or member of the advisory board of an investment company; and (F) the depositor of an unincorporated investment company not having a board of directors. For these purposes, a "person" can mean an entity.

Definitions (continued)

AUM:	Assets under management
BDC:	Business development company. A BDC is a special form of closed-end investment company that is comparable to an interval fund.
Board:	Board of Directors (if the fund is a corporation or LLC) or Board of Trustees (if the fund is a DST)
Closed-end fund or CEF:	A type of investment company that is not statutorily required to offer daily redemptions
Code:	Internal Revenue Code of 1986, as amended
DST:	Delaware Statutory Trust. A DST is a business trust governed by the Delaware Statutory Trust Act. A DST can be structured similar to a corporation or LLC. Interval funds are commonly formed as DSTs.

Definitions (continued)

EDGAR:	The SEC's Electronic Data Gathering, Analysis, and Retrieval system
Interval fund:	A type of closed-end fund offering periodic share repurchases as described in greater detail throughout this course
IPA:	Investment Program Association
LLC:	Limited liability company
NASAA:	North American Securities Administrators Association
Open-end fund (a/k/a mutual fund):	A type of investment company that has daily redemptions of its shares at NAV

Definitions (continued)

Prospectus:	An offering document used in connection with a fund's public offering that contains information about fees and expenses, investment objectives, investment strategies, risks, performance, pricing, and other important information.
REIT:	Real estate investment trust
RIC:	Registered investment company (under the 1940 Act) or regulated investment company (under Subchapter M of the Code)
SEC:	Securities and Exchange Commission, the primary regulator of interval funds
SRP:	Share repurchase program

Definitions (continued)

Statement of Additional Information or SAI:	The SAI is filed with or after the Prospectus and affords the fund an opportunity to expand discussions of the matters described in the Prospectus. The SAI generally includes the fund's financial statements and information (or additional information) about: the history of the fund; some fund policies (such as on borrowing and concentration policies); officers, directors and persons who control the fund; investment advisory and other services; brokerage commissions; tax matters; and performance measures as applicable.
UBTI:	Unrelated business taxable income

The End