

MEMO# 1007

April 7, 1989

MEETING WITH STAFF ON ISSUER TENDER OFFERS

April 7, 1989 TO: CLOSED-END FUND MEMBERS NO. 17-89 RE: MEETING WITH STAFF ON
ISSUER TENDER OFFERS _____ We
previously distributed to you a copy of a letter received by the Institute from the staff of the
Securities and Exchange Commission concerning issuer tender offers by closed-end funds.
(See Memorandum to Closed-End Fund Members No. 10-89, dated February 13, 1989.) In
that letter, the staff expressed its concern that several recent prospectuses of closed-end
funds contained disclosure of prospective issuer tender offers that if conducted as
described would not be in compliance with Rule 13e-4 or Schedule 13E-4 under the
Securities Exchange Act of 1934. Recently, members of the ICI staff met with
representatives of the Divisions of Corporation Finance, Market Regulation and Investment
Management. The staff reiterated the concerns expressed in its letter and discussed in
greater detail some of the problems they have observed in reviewing registration
statements of closed-end funds. Among the issues raised were the following: Review by
Staff. Schedule 13E-4 is required to be filed when a tender offer commences. Thus, the staff
is not able to comment before dissemination. If the Schedule is not in compliance with the
applicable provisions, a fund that has already commenced a tender offer may be forced to
amend the offer, file an amended Schedule 13E-4 and re-disseminate the offering material
to shareholders. The staff stressed that funds should contact the Division of Market
Regulation with any interpretive questions before commencing a tender offer. Investment
Company Act Release No. 3548 (October 3, 1962) implied that tender offers by funds are
reviewed only by the Division of Investment Management. This is no longer the case. "All
Holders Rule". Rule 13e-4(f)(8)(i) requires issuer tender offers to be open to all holders of
the class of securities subject to the offer. Some funds' prospectuses have described tender
offers in which only shareholders as of a certain record date, earlier than the termination
date of the offer, would be eligible to tender their shares. The staff views this as in conflict
with the all holders rule. In addition, closed-end funds should be aware that "odd lot tender
offers" (tender offers made only to holders of fewer than 100 shares), which are permitted
under Rule 13e-4(g)(5), may be prohibited under the 1940 Act. Section 23(c)(2) of the 1940
Act permits closed-end fund tender offers "after reasonable opportunity to submit tenders
given to all holders of securities of the class to be purchased" (emphasis added). In such
cases, funds would be required to comply with Rule 23c-1 under the 1940 Act, which sets
forth various substantive provisions for repurchases that are not made pursuant to Sections
23(c)(1) or (c)(2), or else seek an exemptive order. This was noted in a recent no-action
letter. (Combined Penny Stock Fund, Inc., publicly available Jan. 4, 1989). "Best Price Rule".
Rule 13e-4(f)(8)(ii) requires that the consideration paid to any security holder pursuant to a
tender offer be the highest consideration paid to any other security holder during such
offer. Some closed-end funds apparently have described tender offers in which the fund

would waive certain charges or loads for tendering shareholders who are officers or employees of the fund. Since such officers or employees would, consequently, receive a higher price for their shares, this would appear to violate the best price rule. Another way in which the staff noted that the best price rule could be violated is by the imposition on tendering shareholders of a flat fee that does not vary with the number of shares tendered. Shareholders who tendered a greater number of shares would be receiving a higher price on a per share basis than shareholders who tendered fewer shares. In connection with the amount of consideration paid during a tender offer, the staff noted that frequent dissemination of price information is important, especially as the termination date approaches. Many funds, which base the tender price on net asset value on the last date of the offer, only calculate net asset value weekly. Funds should be aware that, during a tender offer, they may have to compute n.a.v. on a more frequent basis and disseminate this information to shareholders. (The staff suggested that one way to do this might be to have an 800 number that shareholders could call to obtain the current net asset value.)

Financing of Tender Offers. Schedule 13E-4 requires disclosure of the source and amount of cash available for the purchase of the maximum number of securities that may be purchased during the offer. In addition, issuers should be aware of Rule 13e-4(f)(5), which requires prompt payment for shares tendered. Funds that hold illiquid securities may not be able to comply with this requirement if the source of the cash requires a liquidation of portfolio securities. If closed-end funds making a tender offer have to utilize a different source of cash (e.g., borrowing) than that originally disclosed, this might constitute a material change in the terms of the offer and might require dissemination to shareholders and extension of the offering period. (Closed-end funds may also be restricted in their ability to borrow due to restrictions under the 1940 Act.).

Rule 10b-13. Rule 10b-13 prohibits a person making a tender offer from purchasing, or making any arrangement to purchase, any security other than pursuant to the tender offer after the offer has been "publicly announced or otherwise made known by such person to holders of the security to be acquired". Thus, a fund that included in its prospectus disclosure of possible future tender offers might be deemed to have announced a tender offer and thereby prohibited from making other purchases of its own securities. The staff of the Division of Market Regulation, however, indicated that it would be willing to consider granting a no-action position to allow a fund to make open-market purchases until such time as the tender offer is actually commenced.

Rule 10b-6. The staff also referred to a recent no-action letter issued to a closed-end fund that wished to have the flexibility to engage in quarterly tender offers while it engaged in a continuous offering of shares that were the subject of a shelf registration pursuant to Rule 415 under the 1933 Act. In that letter, the staff granted the fund an exemption from Rule 10b-6, which generally prohibits a person engaging in a distribution of securities from bidding for or purchasing a security of the same class. It appeared that the staff viewed the circumstances described in that letter as unique and that the staff might be reluctant to grant future no-action requests in the area. Craig S. Tyle
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