The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 33498

April 26, 2021

NYSE Proposes Amendment to Limit Listed Closed-End Fund Investments in Private Funds

[33498]

April 26, 2021

TO: ICI Members SUBJECTS: Closed-End Funds RE: NYSE Proposes Amendment to Limit Listed Closed-End Fund Investments in Private Funds

The New York Stock Exchange ("NYSE") recently filed a proposed rule change to establish limits on listed closed-end fund investments in private funds.[1] The rule change would prevent the initial listing of a closed-end fund if, at the time of listing, the closed-end fund invests on an aggregate basis more than 15 percent of the fund's net assets in private funds or invests more than 5 percent of the fund's net assets in any single private fund. In addition, the rule change would require a listed closed-end fund that invests in or intends to invest in private funds to adopt fundamental policies providing that the fund: (i) may not make additional investments in private funds if, immediately after the investment, private funds would represent more than 15 percent of such fund's net assets or the investment in an individual private fund would represent more than 5 percent of such fund's net assets; and (ii) will take other actions upon exceeding those limits.[2] **Comments on the proposed rule change are due by Monday, May 17, 2021.**

The proposed rule change would be a departure from NYSE's historic approach on listing closed-end funds. Currently, Section 102.04(A), which authorizes the listing of closed-end funds, does not include any explicit restriction on the kinds of investments a listed closed-end fund may include in its portfolio. The NYSE now is proposing to amend the section because it believes that the restrictions protect investors and the public interest by appropriately addressing concerns about the illiquidity of private fund investments.[3]

The rule would define "private fund" for purposes of Section 102.04(A) as: (1) for domestic entities, an entity that would be an investment company under the 1940 Act but for the exceptions in Sections 3(c)(1) or 3(c)(7) of the 1940 Act; and (2) for foreign entities, an entity that is only permitted to offer its securities in the US in a private offering that complies with Section 7(d) and either Section 3(c)(1) or 3(c)(7) of the 1940 Act and SEC interpretations thereunder.[4] It would exclude issuers of collateralized debt obligations ("CDOs") or collateralized loan obligations ("CLOs") from the definition of private fund.[5] The NYSE believes that CDOs and CLOs have a more active trading market than private

funds, and there is more consistency and transparency in valuing them.

The SEC will (a) by order approve or disapprove the proposed rule change or (b) institute proceedings to determine whether the proposed rule change should be disapproved by Thursday, June 10, 2021. The SEC may extend that date to Monday, July 26, 2021, if it finds such longer period to be appropriate and publishes its reasons for so finding or the NYSE consents to such later date.

Kenneth Fang
Associate General Counsel

endnotes

[1] *See* New York Stock Exchange, Form 19b-4 Filing Proposing to Amend Section 102.04 of the NYSE Listed Company Manual to Establish Limits on Investments in Unregistered Investment Vehicles by Listed Closed-End Funds, *available at* www.nyse.com/publicdocs/nyse/markets/nyse/rule-filings/filings/2021/SR-NYSE-2021-20%20refi.pdf. *See also* Self-Regulatory Organizations; New York Stock Exchange LLC; Notice of Filing of Proposed Rule Change Amending Section 102.04 of the NYSE Listed Company Manual to Establish Limits on Investments in Unregistered Investment Vehicles by Listed Closed-End Funds, 86 Fed. Reg. 22080-82 (Apr. 26, 2021), *available at* www.govinfo.gov/content/pkg/FR-2021-04-26/pdf/2021-08566.pdf.

[2] Specifically, the proposed rule would require a fund that holds more than 15 percent of its net assets in private funds or violates the fundamental policy prohibiting additional investment in a private fund to: (i) immediately inform the NYSE of such occurrence and publicly disclose such occurrence in a manner consistent with the NYSE's immediate release policy; (ii) require fund management to provide the fund's board of directors (within one business day of the occurrence) with an explanation of the extent and causes of the occurrence and how the fund plans to reduce its investments to no more than 15 percent of its net assets or to comply with the fund's fundamental policy, as applicable; and (iii) require the fund's board of directors to assess whether the plan presented to it pursuant to the requirements set forth above continues to be in the best interest of the fund, if the fund's investments in private funds are still above 15 percent or exceeds the fundamental policy 30 days after the occurrence (and at each consecutive 30 day period thereafter).

[3] In support of the proposed rule change, the NYSE cites that the SEC has addressed identical concerns about the inclusion of illiquid asset classes in mutual fund portfolios by adopting the fund liquidity rule imposing a 15 percent limitation on a mutual fund's acquisition of illiquid assets. See Rule 22e-4(b)(1)(iv) under the Investment Company Act of 1940 ("1940 Act"). It adds that the 5 percent limit on individual investments in the proposal is an augmentation of the SEC's limitations with respect to mutual funds.

[4] Section 3(c)(1) of the 1940 Act excepts from the definition of investment company any issuer whose outstanding securities (other than short-term paper) are beneficially owned by not more than 100 persons and that is not making and does not at that time propose to make a public offering of such securities. Section 3(c)(7) of the 1940 Act excepts from the definition of investment company any issuer whose securities are owned exclusively by

persons who, at the time of acquisition, are qualified purchasers and that is not making and does not at that time propose to make a public offering of such securities. An investment company that is organized or otherwise created under the laws of a foreign country generally may not register as an investment company or offer its shares in the US, unless it applies for and receives an exemptive order permitting it to do so under Section 7(d) of the 1940 Act.

[5] To exclude CDOs and CLOs, the NYSE would carve out from the private fund definition an entity that: (i) is engaged in the business of purchasing, or otherwise acquiring, and holding "Eligible Assets" (i.e., financial assets, either fixed or revolving, that by their terms convert into cash within a finite time period, plus any rights or other assets designed to assure the servicing or timely distribution of proceeds to securities holders); (ii) issues securities that are either (A) initially sold to "qualified institutional buyers" or persons involved in the organization or operation of the issuer or an affiliate or (B) securities which entitle their holders to receive payments that depend primarily on the cash flow from Eligible Assets; (iii) appoints a trustee that meets the requirements of Section 26(a)(1) of the 1940 Act and that is not affiliated with such entity, which does not offer or provide credit or credit enhancement to such entity and that executes an agreement or instrument concerning such entity's securities containing provisions set forth in Section 26(a)(3) of the 1940 Act; (iv) takes reasonable steps to cause the trustee to have a perfected security interest or ownership interest valid against third parties in those Eligible Assets that principally generate the cash flow needed to pay the fixed-income security holders, provided that such assets otherwise required to be held by the trustee may be released to the extent needed at the time for the operation of the issuer; and (v) takes actions necessary for the cash flows derived from Eligible Assets for the benefit of the holders of fixed-income securities to be deposited periodically in a segregated account that is maintained or controlled by the trustee consistent with the rating (if any) of the outstanding fixed-income securities.
