Interval and Tender Offer Funds

Here's the deal:

- Interval funds and tender offer funds are registered closed-end funds that may continuously offer their shares at net asset value ("NAV") to an unlimited number of investors.
- Unlike mutual funds, these funds do not provide investors with daily liquidity; instead, these funds allow an opportunity for periodic share repurchases at a predetermined price.
- These funds may be used as vehicles to invest in less liquid assets, such as real estate, private equity or private credit, which makes them a popular option for investors looking for exposure to alternative investments and who are less concerned about a need for daily liquidity.
- Interval funds typically have a regular repurchase schedule (i.e., quarterly, semi-annually or annually), while tender offer funds often repurchase shares less predictably, usually based on specific offers made by the fund.

What's the Deal?

Interval and tender offer funds are different types of registered closed-end funds in which investors have an opportunity to resell their shares back to the funds. Interval funds make repurchase offers to investors on a scheduled, periodic basis. Tender offer funds make repurchase offers to investors at the discretion of the funds. Nonetheless, both types of funds provide investors with unique opportunities to gain access to alternative investment strategies, including investments in equity and debt securities of privately held companies and other alternative asset classes.

Trends

Both interval and tender offer funds have gained popularity among investors seeking access to alternative asset classes such as digital asset futures, fine art and secondary market interests in private funds. They have also become a more favorable option for institutional investors and high-net-worth individuals looking to diversify into other non-public assets. The combined assets of interval and tender offer funds have experienced substantial growth reaching $208 billion at the end of 2024, up from $130.6 billion at the end of 2023. This represents an approximately 60% increase in assets over the period.

Assets under management in only interval funds have grown nearly 40% annually over the past 10 years and nearly 300% since 2018. Launches of new interval funds were minimal (less than six) from 2001 to 2016, and have been in the double digits every year since 2017. In 2024 there were over 20 new interval funds launched. This recent surge can be attributed, in part, to an increased demand by investors to have access to the types of investment opportunities typically only available to institutional and private equity investors.

Tender offer funds have also experienced substantial growth in recent years with private equity sponsors acting as drivers of the expansion. As of the end of 2024, net assets in tender offer funds reached approximately $80 billion, marking an approximately 33% increase from the previous year. The structure of these funds also allows for certain alternative investment strategies that would not be considered suitable for other structures.

As these types of closed-end funds have grown in popularity, regulators have been closely monitoring them. There's been a trend toward increased regulation and scrutiny from the Securities and Exchange Commission (the "SEC"), particularly around the redemption mechanics and the fees that investors pay.

Background on Closed-End Funds

A closed-end fund is a type of investment company that raises a fixed amount of capital through an initial public offering and then typically lists its common stock on a national securities exchange. After its initial public offering, the fund's shares are bought and sold in the open market instead of being purchased or redeemed directly by the fund. Therefore, the market price of closed-end fund shares fluctuate like that of other publicly traded companies. Closed-end funds maintain a fixed number of shares, and no new money will flow into the fund.

Traditionally, investors in closed-end funds "redeem" their shares differently than investors in open-end funds (or mutual funds). Unlike mutual fund shares, closed-end fund shares are not redeemable by the closed-end fund at NAV or otherwise. Most resales of closed-end fund shares are made through secondary markets, either on national securities exchanges for listed shares or over the counter. The market price of listed closed-end shares may be greater than the shares' NAV, but closed-end shares can often be purchased at a significant discount from a closed-end fund's NAV due to market volatility. Because closed-end funds are not required to buy back shares from shareholders, closed-end fund managers do not have the same concerns about constant redemptions as mutual fund managers, and they do not have to manage their funds to account for the possibility of those redemptions. Furthermore, traditional closed-end funds are not subject to the liquidity requirements that apply to mutual funds. As a result, closed-end fund managers often have more flexibility to invest in more illiquid assets.

In 1993, the SEC adopted Rule 23c-3 under the Investment Company Act of 1940, as amended (the "Exchange Act"), which provided exemptive relief allowing certain closed-end funds to make periodic repurchases of their shares.

Closed-end funds that rely on Rule 23c-3 under the Exchange Act to repurchase shares are commonly known as "interval" funds and closed-end funds that rely on Rule 13e-4 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), to make periodic tender offers for shares on a discretionary basis are commonly known as "tender offer" funds.

What Is an Interval Fund?

An interval fund is a type of closed-end fund that engages in continuous offerings of its shares and periodically offers to repurchase its shares from investors. Interval funds offer to buy back a stated portion of their outstanding shares from investors on a periodic interval (often quarterly, semi-annually or annually). Investors are not required to accept these offers or to sell their shares back to the fund. Interval funds are permitted to, and many do, continuously offer their shares at a price based on the fund's NAV.

Often, sponsors choose to create interval funds to provide individual investors with the opportunity to access alternative investment strategies that are typically available to institutional or private equity investors. Interval funds are better positioned to anticipate their liquidity needs than open-end funds because they do not need to accommodate daily liquidity requests, have the flexibility to limit the size and timing of repurchase offers and shareholders are required to provide the fund with advance notice of redemptions.

Investors are permitted to purchase shares from interval funds on any day that the market is open. However, they are limited in when they can sell their shares back to the fund. This limitation allows the fund to invest in certain types of illiquid assets that could have the potential for long-term returns but that are too illiquid for mutual funds or ETFs. When repurchase opportunities are offered, investors are not required to accept offers to sell their shares back to the funds. They are free to hold out for a better price, but they may not exit a fund until the next designated interval repurchase opportunity.

Funds are also limited by the number of shares that can be collectively redeemed in a single repurchase window. If redeeming investors exceed a set percentage of shares during a given redemption window, the fund will execute repurchases on a pro rata basis. At least 5% and up to 25% of outstanding shares may be repurchased by a fund in a single redemption window. The exact percentage is set by the board of the fund, in consultation with the fund's advisers. The percentage can vary in each redemption window; however, it is typically kept the same. The industry standard is 5% per quarter. The SEC also permits some flexibility within a redemption window. An additional 2% of shares can be repurchased during a redemption window without board approval. This is most common in periods of market stress in which shareholders express high demand for repurchases. The board of a fund may also alter the percentage in response to anticipated increases in investor demand, year-end tax considerations or an event such as a change in the fund's investment objective.

Interval fund structures work best with assets that generate regular income or that can be sold in weeks or months. Examples include bonds, floating-rate loans and structured credit, although there are several interval funds that primarily invest in private equity and venture capital, and some that invest in more niche markets like fine art.

Interval funds provide an opportunity for investors to access private credit, which is often a closed-off market, by offering structures that allow for exposure to illiquid investments even while maintaining a degree of liquidity through periodic share repurchases. In fact, interval funds are better positioned to anticipate investors' liquidity needs than open-end funds, because they do not need to accommodate daily liquidity requests. Instead, interval funds have the flexibility to limit the size and timing of repurchase offers, and shareholders are required to give the funds advance notice of their redemptions. Moreover, exposure to private credit, among other asset classes, offers diversification, and periodic repurchases effectively reduce the spread between the market trading price of a fund's shares and the fund's NAV, which helps facilitate additional capital raising following the initial fundraising round.

Operating Interval Funds

Interval funds conduct their repurchase offers pursuant to policies adopted by their boards in accordance with Rule 23c-3 under the Exchange Act, and the frequency, amount and timing of such repurchases are set pursuant to Rule 23c-3.

Interval funds offer to buy back a percentage of their outstanding shares at NAV, usually at a set percentage (e.g., 5-25%) of the fund's total shares. The repurchase is priced at the fund's NAV, not at market prices, which can be advantageous because the fund is not subject to market fluctuations during the redemption period. In order to carry out this repurchase offer, interval funds are required to adopt a policy that is publicly reported in each annual report and states:

- That the fund will make repurchase offers at periodic intervals;
- The periodic interval between repurchase request deadlines;
- The dates of repurchase request deadlines or the means of determining those deadlines; and
- The maximum number of days between each repurchase request deadline and the next repurchase pricing date.

Rule 23c-3 of the Exchange Act regulates the conduct of interval fund repurchases as follows:

- Funds must make periodic repurchase offers to investors every three, six or 12 months, with quarterly offers being the most common and monthly offers also being a possibility;
- Funds must hold highly liquid securities equal in value to 100% of the repurchase offer amount from the time they send notice of a repurchase offer until the repurchase pricing date;
- Funds must disclose the frequency of repurchases in their prospectus and annual report and periodically notify shareholders of upcoming repurchase dates;
- Funds must open their repurchase windows with a written notice for each investor that is consistent with the following requirements:
    - The notice date must be at least 21 days before the repurchase request deadline but can be up to 42 days beforehand;
    - The written notice must also be made available on the SEC's EDGAR platform through the submission of Form N-23C3A – "Notification of periodic repurchase offer";
    - The written notice must contain the following information, in accordance with SEC guidelines:
        - Effective Date: The date the written notice is effective, announcing the start of the repurchase offer for the period;
        - Deadline: Funds must specify the date on which the investor's repurchase request is due;

  - Share Redemption Percentage: The percentage of outstanding shares that the fund is offering to repurchase and how the fund will purchase shares on a pro-rated basis if the offer to repurchase is oversubscribed;
  - NAV Date: The date that will be used to determine the NAV of the fund for the repurchase – the price shareholders receive on a repurchase is based on the per-share NAV determined as of this date;
  - Payment Date: The date by which the fund will pay the proceeds from the repurchased shares to investors (must be within seven days after the repurchase pricing date); and
- The repurchase date must occur after the close of business on a date not more than 14 days subsequent to the deadline (the date that shareholders must submit their acceptances of the repurchase offer).

What Is a Tender Offer Fund?

A tender offer fund is a type of closed-end fund registered under the Exchange Act that conducts periodic tender offers, most often conducted quarterly, on a discretionary basis. Tender offer funds provide investors with liquidity by allowing them to sell their shares back to the fund at a predetermined price rather than selling them on the open market. This price is typically near or at the fund's NAV but can be set at a negotiated discount. Tender offer funds are able to conduct repurchases at their discretion, and have flexibility to value their assets periodically (daily, weekly, monthly). This discretion allows companies to provide controlled liquidity to investors.

Tender offer funds offer investors increased liquidity by allowing them to sell their shares back to the fund at a predetermined price rather than selling them on the open market. Tender offers also provide more flexibility for fund managers in terms of frequency, amount and timing of share repurchases than interval funds, and these funds have no liquidity requirements.

One common purpose for a tender offer is when the fund's shares are trading at a significant discount to the fund's NAV. The fund can seek to reduce the NAV discount by offering to buy back shares and allow investors to earn fair value returns on the shares. These purchases are likely to improve the market price of the fund's shares. It also provides investors the exit opportunity to sell somewhere other than the secondary market. Rule 13e-4 of the Exchange Act sets forth the parameters for commencing, terminating, filing, disseminating and generally conducting a tender offer. At the commencement of a tender offer, the tender offer fund will notify shareholders of the repurchase offer, complete Schedule TO, deliver the Letter of Transmittal to shareholders and file all repurchase offer documents with the SEC. Schedule TO is the tender offer statement of the fund and includes, typically by exhibit, the Offer to Purchase.

While the process for conducting a tender offer is typically more burdensome than conducting an interval offer, Rule 13e-4 of the Exchange Act is less limiting than Rule 23c-3 of the Exchange Act in a few key respects, including that (i) the Board of Directors has the flexibility to skip a tender offer (although commercial considerations may limit its ability to do so); (ii) the amount of the tender offer is not prescribed; (iii) the deadline by which shareholders must receive the proceeds from their tendered shares is not prescribed and (iv) the rule does not prescribe the amount of liquid assets required to be held by the fund in connection with the tender offer.

Tender offer funds have wide latitude in establishing their share repurchase practices. There is no minimum number or frequency of tender offers that must be completed. The predetermined repurchase price for shares is set by Rule 14d-10 (the "best-price rule"). It stipulates that consideration offered to one shareholder must be equal to the highest consideration paid to any other shareholder. The purpose is to provide equal treatment to all shareholders in the fund. The fund sets the repurchase price, typically set at a premium to the fund's current market price in order to incentivize shareholders to sell their shares back to the fund.

Conducting Tender Offer Fund Repurchases

When a fund conducts a tender offer, there are several legal considerations it must navigate to ensure compliance with securities laws, regulations and corporate governance standards. While the fund's board of directors has the discretion to determine the tender offer amount, the tender offer must have a duration of at least 20 business days, and at least 10 business days after any material changes are made to the tender offer. The tender offer must be made to all shareholders of the class of securities being sought in a non-discriminatory manner. This is important to ensure equal treatment for all shareholders. If repurchases exceed the repurchase offer amount, tender offer funds can modify the offer to accommodate the oversubscription or accept tenders on a pro rata basis, subject to other allowances for accepting tenders.

The fund must provide shareholders with clear and concise information about the tender offer, including the offer terms, how to accept or reject the offer and any other relevant information for shareholders to make an informed decision. Shareholders typically receive an Offer to Purchase and Letter of Transmittal that specify the shares being tendered and include investor identification and payment instructions. All repurchase offer documents must be publicly filed by the fund with the SEC on Schedule TO (Tender Offer Statement). Schedule TO is required to disclose detailed information relating to the tender offer, including:

- Full terms of the tender offer;
- The purpose of the tender offer;
- The source and amount of the redemption proceeds;
- Disclosure of certain affiliated transactions in the prior two years, significant corporate events in the past two years and any agreements involving the fund's securities;
- Disclosure of all advisers or solicitors engaged by the fund with respect to the tender offer;
- Audited financial statements for the prior two fiscal years and unaudited financial statements from the most recent fiscal quarter prior to the offer;
- Potential tax consequences of the tender offer, such as capital gains tax implications; and
- Other fund and financial information.

Regulation

Regulations 14D and 14E of the Exchange Act address tender offers. Regulation 14D governs the tender offer process and ensures that the terms of the offer are disclosed to all shareholders. Regulation 14E outlines additional requirements regarding the timing, disclosure and pricing of tender offers. Section 23 of the Exchange Act limits the ability of a closed-end fund to repurchase its shares. Interval funds are subject to Rule 23c-3, which provides an exemption to the limitations of Section 23. This rule establishes general requirements for the terms of closed-end fund repurchases at periodic intervals of three, six or 12 months. Interval repurchases must be a "fundamental policy" of the fund. This policy must state (i) that interval repurchases are allowed, (ii) the frequency of the period intervals between repurchase request deadlines, (iii) the dates of repurchase request deadlines or the means of determining the repurchase request deadlines and (iv) the maximum number of days between each repurchase request deadline and the next repurchase pricing date. A repurchase offer cannot be suspended or postponed except by a vote of a majority of the fund's independent directors. Notice must be sent to each record shareholder and each beneficial owner not less than 21 days before each repurchase request deadline. If shareholders tender more than the repurchase offer amount, the fund may repurchase an additional amount not to exceed 2% of the outstanding shares.

Section 18 of the Exchange Act generally prevents closed-end funds from creating multiple share classes; however, both interval and tender offer funds may be granted exemptions by the SEC to issue multiple classes of shares. The process for multi-share class exemptive relief involves submitting an application containing a detailed explanation on why relief is needed along with detailed information about the proposed share classes. This process has become routine with the SEC and applications are often eligible for expedited review and approval. This allowance for multiple classes allows closed-end funds to attract a wider range of investors by offering different opportunities for investment.

Both interval funds and tender offer funds are permitted to borrow money from financial institutions such as banks or issue preferred shares to generate leverage, making them more flexible than mutual funds that are unable to issue preferred shares and generally limited to borrowing from banks for leverage. Section 18 of the Exchange Act also sets asset coverage limitations of closed-end funds to 300%, or 200% for preferred stock; however, other leverage limitations are only applicable to interval funds and not tender offer funds. For example, Rule 23c-3 of the Exchange Act requires that any indebtedness incurred by an interval fund must mature or be subject to redemption prior to the fund's next repurchase pricing date. This restriction can prevent interval funds from taking on leverage that would interfere with their next repurchase offers while tender offer funds can be more flexible with the types of preferred securities they issue.

Both interval and tender offer funds are subject to FINRA Rule 2341, which imposes varying caps on sales compensation/distribution fee levels. They are exempt from FINRA Rule 5110, which seeks to prevent unfair underwriting arrangements in connection with the public offering of securities and requires the filing of underwriting terms and arrangements with FINRA. Interval funds that make periodic repurchases under Rule 23c-3 of the Exchange Act and make continuous offerings of their securities under Rule 415 of the Securities Act of 1933 (the "Securities Act") are exempt from this rule and tender offer funds that make continuous offerings under Rule 415 of the Securities Act, do not list their securities on an exchange, price their securities at least quarterly, impose limits on compensation to underwriters and have at least two repurchase offers are also exempt from this rule.

Generally, Section 205 of the Investment Advisers Act of 1940 (the "Advisers Act") prohibits advisers from charging performance fees. However, closed-end funds may charge performance fees if all shareholders of the fund are "qualified clients" under Rule 205-3 of the Advisers Act. Closed-end funds are also permitted to charge a fulcrum fee, a type of performance fee that is adjusted up or down based on how the fund performs against a specific benchmark. When interval and tender offer funds take on a fund-of-funds strategy where they invest assets in other privately offered investment vehicles, the underlying funds are permitted to charge performance fees.

Offerings of Securities

Interval and tender offer funds are required to file a registration statement on Form N-2 with the SEC prior to issuing shares to the public. Form N-2 is a three-part registration statement requiring a prospectus, statement of additional information ("SAI") and other information. This is the primary offering document for closed-end funds and includes details about the fund, including its investment objectives, portfolio holdings, management fees, risk factors and rights of shareholders. The prospectus must also contain information about the plan of distribution and use of proceeds to provide investors with important information about the fund's offering. The SAI requires more detailed information about the fund, management and the fund's investment objective and policies. Other information that must be disclosed includes additional background information regarding the fund, the track record of the fund's adviser, incorporation documents, material contracts and fund policies. Since 2020, the SEC has allowed closed-end funds to file short-form registration statements that allow them to omit certain information from their prospectus at the time their registration statement becomes effective, as long as they provide the missing information in a prospectus supplement.

Interval and tender offer funds rely on Rule 415 of the Securities Act in order to offer shares on a continuous or delayed basis. They also rely on Rule 486 of the Securities Act, which allows for post-effective amendments of the funds to become immediately effective without SEC review. Under Rule 486 of the Securities Act, a qualifying closed-end fund can have their registration statement become immediately effective if it is filed to register additional shares where a Form N-2 is already effective, share update financial statements, designate a new effective date for a previously filed post-effective amendment, update information regarding portfolio managers, make any non-material changes or other actions that receive SEC approval. Rule 486 may also be relied on for other purposes with automatic effectiveness after 60 days.

Interval fund and tender offer funds are also required to comply with state "blue sky" notice filing and fee laws. They must coordinate notice filing and fee payments in each state and territory where they intend to conduct offerings.

Ongoing Reporting Requirements

Both interval and tender offer funds must file monthly investment holdings reports and publicly file quarterly disclosures of investment holdings with the SEC.

Funds are required to file financial reporting documents with the SEC through Form N-CSR and N-PORT. Form N-CSR must be filed with the SEC within 10 days of a fund disseminating annual and semiannual reports to stockholders and Form N-PORT is used for monthly reports.

Rule 23c-3 of the Exchange Act also requires that an interval fund's annual report discuss the policies of the fund and provide information on the prior year's repurchase offers, including the number of offers, the repurchase offer amounts and the amount tendered in each repurchase offer. Rule 13e-4 of the Exchange Act requires tender offer funds to file a Schedule TO (discussed above) with the SEC as soon as possible on the date that a tender offer fund is commencing. Any material changes made to information included in the Schedule TO must be promptly updated with an amendment.

Checklist of Key Questions

- What are the liquidity terms of the fund?
- How frequently are redemption opportunities offered, and is there a limit on how many shares can be redeemed at each interval?
- What are the risks associated with the fund?
- How frequently are reports and disclosures provided to investors?
- Are there any limitations on the amount or timing of redemptions that might hinder liquidity?
- What are the tax implications of the fund's structure?
- What does the growing popularity of these types of funds mean for future investment?
- What is the expected maturity date or exit strategy of the fund?