

COVID-19 ALERT: Special Considerations for Registered Closed-End Funds

By Deborah Bielickie Eades, Jacob C. Tiedt and Nathaniel Segal

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This Alert focuses on special considerations for closed-end funds registered under the Investment Company Act of 1940, as amended (the '1940 Act'), arising from COVID-19 (coronavirus) and related regulatory relief of interest to such funds. Recent market volatility and dislocations arising from COVID-19, together with remote operations, raise special considerations for registered closed-end funds with shares that trade on a national exchange that are not present for mutual funds. Please visit our [Coronavirus Task Force/Investment Services Resources](#) section of our website for additional Alerts applicable to all registered investment companies.

Offering and Disclosure Considerations

- Closed-end funds generally cannot issue shares at below net asset value ("NAV"), subject to limited exceptions. Current volatile market conditions may eliminate premiums and widen trading discounts. As a result, funds may be unable to offer additional shares or may be required to suspend the offering of their shares (see below). This is particularly relevant for funds with a shelf registration statement.
- The undertaking under Item 34.1 of Form N-2 requires a closed-end fund to suspend the offering of its shares until the prospectus is amended if, subsequent to the effective date of the registration statement, the NAV of the offered shares declines by more than 10% from the NAV as of the effective date of the registration statement. As of the date of this Alert, some closed-end funds have announced suspensions of sales. The SEC staff recently issued guidance stating that a closed-end fund whose NAV has declined more than 10% as a result of current market conditions relating to COVID-19 may satisfy the Item 34.1 undertaking by filing a prospectus supplement under Rule 497, provided the fund gives the staff one business day's advance notice. The fund may restart offering shares when the prospectus supplement is filed. The guidance also discussed disclosure that a closed-end fund may wish to include in the prospectus supplement, including the extent of, and reasons for, the closed-end fund's NAV decline, that the decline caused the fund to suspend its offering pursuant to the undertaking, and the date on which the fund will restart offering shares, as well as any other material information, including how current market conditions have affected the fund and its investments.
- Any closed-end fund relying on no-action relief¹ to conduct Rule 415 shelf offerings makes the applicable undertakings in Item 512 of Regulation S-K. Among these is the undertaking in Item 512(a)(1)(ii) "to reflect in the prospectus any facts or events arising after the effective date of the registration statement . . . which, individually or in the aggregate, represent a fundamental change." This undertaking requires an amendment to the registration statement (not merely the form of prospectus) when there is a 20% change in the maximum aggregate offering price from that set forth in the calculation of the registration fee table in the effective registration statement. Note that a new set of undertakings applicable to closed-end funds that rely on Rule 415 will become effective August 1, 2020 in connection with revisions to Form N-2 being implemented as part of closed-end fund offering reform.

¹ See, e.g., Pilgrim America Prime Rate Trust (May 1, 1998).

- Closed-end funds that have shelf registration statements or are conducting other offerings, including private placement offerings for leverage purposes, may want to evaluate whether to add or increase disclosure regarding market disruption or “force majeure” risks or other risks related to the impact of COVID-19. For leverage related offerings, funds may also wish to evaluate disclosure regarding a failure to meet asset coverage tests or other covenants, as well as disclosure regarding the implications of declining interest rates on preferred dividends.
- Closed-end funds may wish to assess whether additional disclosure is warranted in shareholder reports or otherwise regarding market conditions, impact on leverage facilities and asset coverage tests, any changes in investment strategy or other COVID-19 related risks.

Shareholder Meeting Considerations

- Closed-end funds with shares that trade on an exchange are required to hold an annual meeting of shareholders to elect directors. The staff of the Securities and Exchange Commission (SEC) has issued guidance with respect to changing the date, time or location of an annual meeting, as well as guidance regarding conducting virtual or hybrid meetings (see our [Alert](#) discussing this relief). Some states, including Massachusetts, have issued relief regarding virtual and hybrid meetings. Many closed-end funds with meetings occurring during the pendency of “stay-at-home” orders or guidelines have evaluated and are implementing these options. It is important to consult counsel regarding state law requirements and to evaluate whether any bylaw amendments are necessary to implement these options. In addition, funds with contested elections or heavy dissident activity should carefully weigh the advantages and disadvantages of these options.
- To the extent that a closed-end fund is conducting a special meeting, including for business combinations, the staff of the SEC has confirmed that the above guidelines regarding annual meetings would apply.
- The staff of the SEC has encouraged issuers, to the extent feasible under state law, to provide shareholder proponents with the ability to present their proposals through alternative means, such as by phone, during the 2020 proxy season (see our [Alert](#) on this topic).

Trading Considerations

- Closed-end funds that have experienced significant declines in market value in recent weeks may be at risk of violating the continued listing standards of their listing exchange. Under NYSE rules, a closed-end fund would fail these standards if (1) the average closing price per common share over a consecutive 30-trading-day period is less than \$1.00; or (2) the total market value and aggregate net asset value of publicly held shares (i.e., shares not held by directors, officers, their immediate family members or 10% owners) is less than \$5 million over 60 consecutive calendar days.
- Funds that have experienced significant declines in the market value of their shares may wish to evaluate conducting a reverse stock split whether or not listing conditions are in jeopardy. A reverse stock split necessarily results in fewer shares outstanding and impacts daily trading volumes. In establishing a conversion ratio, funds may want to balance considerations with respect to share price objectives and liquidity.
- Markets for certain asset classes in which closed-end funds invest, including both taxable and municipal fixed-income securities as well as preferred and capital securities, have experienced significant volatility and lack of liquidity in recent weeks. In addition, closed-end fund trading discounts have generally widened—in some cases significantly—which has resulted in investor losses exceeding declines in net asset value and created opportunities for activist investors.

Leverage Considerations

- Closed-end funds that have outstanding borrowings, debt securities or preferred shares should may wish to review processes for monitoring asset coverage and effective leverage covenants in leverage documents and familiarize themselves with notification requirements, cure periods and options to remedy breaches. Breaches of these requirements typically require prompt notification to the lender or holder of shares, often in a specified format.
- The SEC has temporarily exempted closed-end funds from the requirement to provide 30 days' advance notice of redemptions on Form N-23C-2 through August 15, 2020 (see our [Alert](#) regarding this relief). Funds that are considering relying on this relief should ensure that an abbreviated notice period is consistent with state law requirements and documentation governing the securities.
- Closed-end funds that have outstanding leverage that is rated by a rating agency may want to evaluate their continued ability to comply with rating agency guidelines and the implications of a failure to do so.
- Funds that have leverage facilities that are expiring or approaching their term redemption date may want to allow ample time to evaluate refinancing options. Certain lenders or banks may be unwilling to continue leverage facilities at all or under existing terms.
- Closed-end funds may want to evaluate the terms of documentation for both structural leverage (i.e., borrowings, debt securities or preferred shares) and financial leverage (i.e., derivatives). Among other things, funds may want to identify and evaluate events of default or termination events and material adverse change clauses that may be implicated by COVID-19 related events.

Other Operational Considerations

- Closed-end funds may hold less liquid asset classes. Funds may want to review processes for monitoring the performance of pricing vendors and evaluating when prices become unreliable.
- For closed-end funds that do not publish daily NAVs, funds may wish to consider whether updates to the last published NAVs are necessary.
- For closed-end funds operating pursuant to managed distribution exemptive orders from the SEC, funds may want to consider whether market conditions impair the fund's ability to satisfy the conditions of the order. Such conditions include limitations on public offerings if the fund does not maintain certain performance-to-distribution rate ratios.
- If a fund implements material policy changes as a result of market events surrounding COVID-19, such as material changes to leverage amounts, changes in distribution policies or material investment policy changes, a fund may want to consider whether such changes require or warrant a press release or notification to the exchange.

If you have questions about this law, please contact **Deborah Bielicke Eades** at +1 (312) 609 7661, **Jacob C. Tiedt** at +1 (312) 609 7697, **Nathaniel Segal** at +1 (312) 609 7747 or any other Vedder Price attorney with whom you have worked.

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