ROPES & GRAY

ALERT

Asset Management

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Investment Companies Affected by the Economic Growth, Regulatory Relief, and Consumer Protection Act

President Trump signed the Economic Growth, Regulatory Relief, and Consumer Protection Act (the "Growth Act") into law on May 24, 2018. Most of the news headlines regarding the Growth Act have focused on its rolling back provisions of the Dodd-Frank Act (the impacts of the Growth Act on the Dodd-Frank Act are described in a separate Ropes & Gray Alert). However, the Growth Act also contains provisions relevant to the investment management industry:

- ***Closed-End Funds.*** The Growth Act directs the SEC to amend existing offering and proxy rules to permit closed-end funds to use offering and proxy rules currently available to other Exchange Act-registered issuers, subject to conditions the SEC determines appropriate.

- ***Expanded 3(c)(1) Exemption.*** The Growth Act amends Section 3(c)(1) of the 1940 Act by adding an exemption from the definition of "investment company" for any private "qualifying venture capital fund" (a newly defined term) with no more than $10 million in capital and the outstanding securities of which are beneficially owned by no more than 250 persons.

- ***Investment Companies Organized in a U.S. Possession.*** The Growth Act amends the 1940 Act to require investment companies created under the laws of Puerto Rico, the U.S. Virgin Islands or any other U.S. possession to register with the SEC under the 1940 Act within three years and subject to existing exemptions.

These three provisions are summarized below.

I. Effects on Closed-End Funds

The Growth Act directs the SEC by May 24, 2019 to propose, and by May 24, 2020 to finalize, rules to permit any registered closed-end fund that is either exchange listed or that makes periodic repurchase offers pursuant to Rule 23c-3 under the 1940 Act "to use the securities offering and proxy rules, ***subject to conditions the Commission determines appropriate***, that are available to other issuers that are required to file reports under Section 13 or Section 15(d) of the [Exchange Act]."[1] The SEC's actions are required to consider the availability of information to investors, including what disclosures are sufficient so that a closed-end fund can be designated a well-known seasoned issuer (a "WKSI"), as defined in Rule 405 under the Securities Act.[2]

The SEC may exercise its authority to add conditions to existing offering and proxy rules when applied to closed-end funds and, therefore, the Growth Act stands in contrast to recently enacted legislation (described in this Ropes & Gray Alert) applicable to closed-end funds that elect to be regulated as business development companies (each, a "BDC"). Specifically, the Small Business Credit Availability Act (the "SBCAA"), enacted in March 2018, directed

[1] Emphasis added.

[2] Rule 405 currently excludes registered investment companies from WKSI status. Broadly speaking, in order to qualify as a WKSI, an issuer must have (i) a public float (*i.e.*, a market value of its outstanding voting and non-voting common equity held by non-affiliates) of least $700 million and (ii) been subject to and satisfied the filing requirements of the Exchange Act for at least twelve calendar months immediately preceding the filing of a registration statement, including a shelf registration.

the SEC to amend existing rules and forms to permit all BDCs to use the securities offering and proxy rules that are available to other Exchange Act registrants. However, the SBCAA did not reserve for the SEC power to impose additional conditions and expressly directed the SEC, among other things, to amend its rules and forms so that a BDC will be able to:

- Qualify as a WKSI;
- Rely on safe harbor rules (i) permitting an issuer to make regular publication of factual business information and forward-looking information in the ordinary course of business without the communication being deemed an offer and (ii) permitting issuer communications around the time of an offering without violating the "gun-jumping" provisions of the federal securities laws;
- Rely on an "access equals delivery" model for prospectus delivery, whereunder delivery requirements are met if a final prospectus is filed electronically with the SEC, and investors are notified that they have the right to request physical delivery of a final prospectus;
- Rely on codified shelf registration provisions to raise additional capital through continuous or delayed offerings (and, if a WKSI, to file automatically effective shelf offerings on Form N-2); and
- In any registration statement, to incorporate by reference information previously filed with the SEC.

In implementing the Growth Act's direction regarding offering and proxy rules, the SEC may impose conditions on closed-end funds that do not apply to other Exchange Act registrants. The total assets of closed-end funds are a multiple of the total assets of BDCs.[3] In light of these and other differences, it is possible that, when the SEC gives full effect to the Growth Act, closed-end funds may be subject to conditions under offering and proxy rules to which BDCs (after the SEC gives full effect to the SBCAA) will not be subject.

The Growth Act also provides that, if the SEC fails to meet the deadlines set out above, then each exchange-listed and Rule 23c-3 interval closed-end fund will automatically be deemed an "eligible issuer" under the SEC's 2005 Securities Offering Reform release.[4]

II. Expanded 3(c)(1) Exemption

The Dodd-Frank Act eliminated the private adviser exemption in the Advisers Act and added new Section 203(l) to exempt from registration any investment adviser that solely advises venture capital funds. The term "venture capital fund" is defined in Advisers Act Rule 203(l)–1 and generally applies to any fund that (i) would be an investment company but for the exceptions provided under Sections 3(c)(1) or 3(c)(7) of the 1940 Act, (ii) represents to investors that it pursues a venture capital strategy, (iii) invests predominantly in private operating companies and (iv) employs a limited amount of leverage. Separately, Section 3(c)(1)'s exemption from the definition of investment company generally is available to a private fund that is beneficially owned by no more than 100 persons.

The Growth Act expands Section 3(c)(1)'s exemption from the definition of investment company to apply to any "qualifying venture capital fund" (a newly defined term) that is beneficially owned by no more than 250 persons. A

[3] *Compare* Investment Company Institute, 2018 Investment Company Fact Book 107 (closed-end fund assets $275 billion at year-end 2017) *with* Small Business Investor Alliance, *avail. here* ("53 traded BDCs with $33 billion aggregate market cap and $60 billion in assets").

[4] Rel. No. 34-52056 (Aug. 3, 2005). Technically, "eligible issuer" is not defined in that release, while an "ineligible issuer" is defined generally as an Exchange Act registrant that is not current with its required Exchange Act filings. In addition, various form amendments would be required to fully implement the Growth Act. Therefore, it is unclear what would happen if the SEC were to fail to meet the deadlines in the Growth Act.

qualifying venture capital fund is a venture capital fund, as defined in Advisers Act Rule 203(l)–1, that has no more than $10 million in aggregate capital contributions and uncalled committed capital.

III. Investment Companies Organized in a U.S. Territory

Section 6(a) formerly provided that any investment company organized or otherwise created under the laws of, and having its principal place of business in, Puerto Rico, the Virgin Islands or any U.S. possession would be exempt from 1940 Act registration, provided that the investment company's exemption would terminate if it offered for sale or sold its securities to a resident of any U.S. jurisdiction other than its home jurisdiction (each a "Possession Fund").

The Growth Act eliminates Section 6(a), thereby subjecting Possession Funds to registration under the 1940 Act, unless a pre-existing exemption is available. The Growth Act provides a three-year safe harbor for Possession Funds to transition to federal registration.

IV. Observations

The SEC's response to the Growth Act's directions regarding exchange-traded and interval closed-end funds presents an opportunity for these funds to benefit from a reduction of their regulatory burdens by relying on the securities offering and proxy rules available to other Exchange Act registrants. Among other things, these closed-end funds will be able to take advantage of regulations that streamline follow-on offerings of the funds' securities. Accordingly, closed-end fund sponsors and advisers are likely to urge the SEC to provide regulatory relief to closed-end funds that is as broad as the relief required to be provided to BDCs under the SBCAA. Under the Growth Act, the SEC has until May 24, 2019 to make its implementing proposals, although there is likely to be significant industry discussion and commentary well before that date.

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