‘Interval funds’ are growing in popularity, especially for alternative investments

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Joshua Deringer

Chuck Jaffe, in the NAVigator podcast, interviewed Joshua Deringer, chairman of the investment management group at the law firm Drinker, Biddle and Reath. In the Q & A below Joshua explains the inner workings of 'interval funds', a type of closed-end fund that is not publically traded, but is growing in popularity. The podcast itself can be found on AICA’s website by clicking here: https://aicalliance.org/alliance-content/pod-cast/

CHUCK JAFFE: Joshua Deringer, partner at Drinker, Biddle and Reath is here, and we're talking about interval funds, an unusual and special type of closed-end fund, today on the NAVigator. This is the NAVigator, where we talk about all-weather active investing and plotting a course to financial success with the help of closed-end funds. The NAVigator is brought to you by the Active Investment Company Alliance, which is a unique industry organization that represents all facets of the closed-end fund industry from users and investors, to fund sponsors and creators. So if you're looking for excellence beyond indexing, well, the NAVigator's going to point you in the right direction. Today, I'm joined by Josh Deringer, chair of the investment management group at Drinker, Biddle and Reath, and we want to talk about that whole industry that the AICA represents. Well, Drinker, Biddle and Reath is a law firm, a group that represents various types of funds, and helps them get registered and get them off to a good start. If you want to learn more, DrinkerBiddle.com. Better yet, there is a long link that you can find that will get you directly to the pieces of Drinker, Biddle that are related to this. It's linked up both at the

MoneyLiveShow.com website, and the AICAlliance.org website. Josh Deringer, great to talk with you.

JOSH DERINGER: It's great to talk with you as well. Thank you for having me today.

CHUCK JAFFE: Interval funds, this is a type of closed-end fund that is growing in popularity, that is a really interesting tool that is not publically traded, which makes a lot of people nervous, and it's also got a little SEC interest. So help us understand, how do these work and why are they becoming more popular? Why have they become maybe more interesting as investment tools?

JOSH DERINGER: An interval fund is a particular type of closed-end fund, however I like to tell people by describing them as closed-end funds, that's a bit of a misnomer. And the reason I say that, is they're actually not closed-ended, they're continuously offered. They may be offered on a daily basis, they may be offered on a monthly basis, but they're a sort of evergreen fund structure. However, under the SEC's regulations under the Investment Company Act, any fund that's not a daily redeemable fund like a mutual fund, is considered to be a closed-end fund. So these funds are registered with the SEC as closed-end investment companies, but as you mentioned Chuck, they're not publically traded. They are publically offered in an IPO, so their securities are properly registered, but there's no secondary market for them. They're offered on a continuous basis by the fund, and they provide investors with periodic liquidity through a tender offer process. So investors are promised in an interval fund that they will be able to get money back, they will be able to get liquidity at a set interval of every three, six, or twelve months.

CHUCK JAFFE: That's where the interval comes in an interval fund. It's about how often you can get your money back, and what the process is. And that's all laid out, so there's no real surprise here. The surprise can be of course, that when you have something that is not liquid, it can wind up moving fairly dramatically between times when it is priced. So are there buffers and things that help avoid those surprises? Are there things that are part of the SEC registration process that will help alert someone to, "This is an interval fund that maybe has a little more volitity or a little more pricing sensitivity"?

JOSHUA DERINGER: There's not anything in the rules that deals directly with volatility within the interval fund structure. The regulations essentially provide that, as I noted, you have your interval be set at three, six, or twelve months. And I should note that that one piece, the three, six, or twelve month interval, is something that has to be set at the beginning of the fund, and the fund sponsor cannot change the frequency of that interval without going back to shareholders in a shareholder meeting and getting their approval to change it. Within those intervals however, the fund sponsor is given flexibility as to how much they will offer to buy back from investors. That amount has to range from five to twenty five percent of the outstanding common stock that can be repurchased on any interval date. And if that interval is over subscribed, then everybody gets cut back on a pro rata basis, subject to a two percent buffer that's built into the rule. There is some pricing requirements; an interval fund must be able to price it's securities at least once per week. And on the days leading up to one of the intervals, for the five days prior to the interval, it has to be able to price it's portfolio on a daily basis.

CHUCK JAFFE: This is a particularly effective way it seems, you can correct me if I'm wrong, to do things like high-yield investing. So how does someone find out about what interval fund options are out there when they're not just traded on exchange for you to go off and do research?

JOSHUA DERINGER: The universe of interval funds, which as you had noted, it's gained a lot of popularity. Although the interval fund structure has been out there for a number of years, they really hadn't been very popular until a couple of years ago. Since that time, they've grown rapidly. It's still the case, there are not a large number of the interval funds out there. Because they're not traded on an exchange, you generally have to buy an interval fund through a financial intermediary platform. So whether it's through your registered investment advisor, or through your broker dealer, and they have to have a selling arrangement in place much like the mutual fund space works. Where you need to be purchasing through a broker or financial advisor that has a selling arrangement with respect to that fund.

CHUCK JAFFE: But you don't have to be an accredited investor. You don't have the things that you would have with certain private equity investments or things along those lines.

JOSHUA DERINGER: That's correct, with a caveat. There is a fund structure very, very similar to interval funds that we typically refer to as tender offer funds. They're almost identical to the end user, the main difference is that the intervals are not set or limited at three, six, or twelve months and you can change them. You can have a quarter for instance, where you don't offer any liquidity. Those structures are subject to less rigorous requirements with respect to the pricing of the securities, and are commonly utilized by fund structures like fund of private equity funds, or funds of hedge funds. Those pursuant to current SEC policy are limited to accredited investors. True interval funds that are trading for instance in the credit markets, many of the interval funds traded in private credit for instance, those are available to retail investors. You do not have to be accredited. So it's something similar to a traditional evergreen private equity or hedge fund type structure, but for retail investors.

CHUCK JAFFE: What is spurring more creation of interval funds? What's driving the interest right now?

JOSHUA DERINGER: So I think the interest in interval funds is coming from a few different angles. One development we've seen in the market, is that a few years ago, fund sponsors that did not want to do a traditional closed-end fund and do a traditional closed-end fund IPO, were coming to market with what was commonly referred to as liquid alternative funds. So open-end or mutual funds utilizing alternative strategies. I think it's fair to say that both the regulators and fund sponsors and investors came to realize that some of the strategies were not appropriate for a daily liquidity fund. The strategies were too illiquid. That's one of the reason the SEC just recently adopted new rules that mutual funds are required to adhere to, to adopt liquidity management programs to deal witih some of these issues. But one of the things that spurred is investor interest in a semi-liquid fund structure that was more appropriate for these strategies, and the interval fund structure, which again had been out there but not really popular, is a really nice vehicle for those less liquid strategies. That investors can get a redeemable security that's not traded on a secondary market price and that's not subject to market price volitility, that's bought and sold in asset value, but not on a daily basis.

CHUCK JAFFE: I have so many more questions, but what I don't have is more time. But I know that we will come back and talk about interval funds and non-traded closed-end funds in the NAVigator in the future. Meanwhile, Josh Deringer, thanks so much for joining me.

JOSH DERINGER: Thank you for having me.

CHUCK JAFFE: Joshua Deringer is chair of the investment management group for the law firm Drinker, Biddle and Reath. You can learn more at DrinkerBiddle.com. To learn more about closed-end investing and interval funds, go to AICAlliance.org, the website for the Active Company Investment Alliance. Well, the NAVigator got us off to a good start on the Friday, October 18th edition of Money Life, but up next I'll be talking with Mona Mahajan, investment strategist from Allianz Global Investors. We'll talk the market when we come back in just a moment.

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To request a particular topic for The NAVigator podcast please send an email to: TheNAVigator@AICalliance.org

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