



## UMB's Gallagher Discusses The Evolution Of Tender-Offer Funds

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Chuck Jaffe, in The NAVigator podcast, interviewed Terry Gallagher, executive vice president at UMB Fund Services. Read the Q & A below as Terry explains why he sees an industry-wide trend towards the development of new interval and tender-offer funds. Gallagher—whose firm helps investment companies launch new issues—covers the reason why the structures are growing in popularity, the tax implications that issuers consider when setting up a fund and more.



Terry Gallagher

The podcast can be found on AICA's website by clicking here: <https://aicalliance.org/alliance-content/pod-cast/>

**CHUCK JAFFE:** Terry Gallagher, executive vice president at UMB Fund Services is here, and we're discussing new developments in closed-end funds now on The NAVigator. Welcome to 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's brought to you by the Active Investment Company Alliance, a unique industry organization that represents all facets of the closed-end fund industry, from users and investors to fund sponsors and creators. If you're looking for excellence beyond indexing, The NAVigator will point you in the right direction. Talking about fund creators and fund sponsors, today we're talking with someone who's firm helps companies develop the funds themselves. His name is Terry

Gallagher, he's executive vice president at UMB Fund Services, which is online at UMB.com. They help investment companies launch funds, and among the new developments, you've heard a lot on a not new development in The NAVigator recently, we've talked a bunch about interval funds. But one of the other developments has been something called tender-offer funds. So we're going to discuss what fund companies consider when they're launching funds, and why they're choosing these types, and what's happening with the growth of them. Terry Gallagher, thanks for joining me on The NAVigator.

**TERRY GALLAGHER:** It's good to be here, Chuck. Thank you.

**CHUCK JAFFE:** Let's start with tender-offer funds because they're becoming increasingly popular but a lot of people don't really understand how they work. So we are talking about unlisted actively managed interval funds and tender-offer funds, explain how a tender offer fund works, maybe a little bit of a refresher on interval funds too.

**TERRY GALLAGHER:** Sure. Structurally tender-offer funds and interval funds work the same. An interval fund typically offers purchases on a daily basis, while tender offer funds offer purchases on a monthly or quarterly basis. Both offer repurchases but interval funds are defined in their offering documents, the timing and the amount that they will take, while tender offers have more flexibility in the amount tendered and the timing of those tenders. Either could be offered to retail or accredited investors, but what really drives the decision between the two is the type of investments that are going to be offered inside of the vehicle and whether there's going to be a performance fee involved. Basically if the underlying investment itself would only be available to accredited investors, than the fund itself would only be available to accredited. Also, only accredited investors can invest in a fund that has a performance fee. Retail funds can only have what's called a fulcrum fee, which has a fee that will go up and down depending on the performance of the fund.

**CHUCK JAFFE:** Accredited investors are individual investors who have earned income that was over \$200 thousand, or \$300 thousand if you file jointly with your spouse, in each of the last two years, and you expect to get the same kind of income in the current year. Or you've got a net worth over a million dollars, either alone or with a spouse. Now with that out of the way, why does a fund company say, "This structure is best for me." And what are they trying to achieve with each fund structure?

**TERRY GALLAGHER:** We do like to be brought in early in the discussion so we can help the advisors focus on that opportunity and raise the issues that need to be addressed up front. The big key comes down to, if you're looking to offer it to retail investors, then the investments underneath it need to be available to retail investors. So we work with the advisor in defining really what their investment vehicles are going to be, and whether it matches that piece of it, whether they're available to be offered by retail investors. The other piece that we like to work with them on is the understanding of the valuation process as well as meeting some of the tax qualifications that would go along with it.

**CHUCK JAFFE:** As companies are putting these together, they have implications not only the front end, here's how the fund works, but they have it as well on the backend, on how these issues are taxed, right?

**TERRY GALLAGHER:** Correct. To qualify as a regulated investment company for tax purposes and then be able to issue 1099s, which is often the focus of these, trying to get away from having to do K-1s in a smaller investment pool, but to issue 1099s. There are certainly qualifications that the fund has to meet under the IRS rules to qualify as a regulated investment company. Those primarily are diversification and the income test. So for diversification the fund needs to be diversified, and needing to look at the investments itself and look through those investments to underlying vehicles to be able to prove and show that you've met the diversification. A good example would be in a fund of funds, one fund owning other funds, we need to be able to look through to that underlying fund to be able to see if we've met diversification requirements, and getting that information is often difficult to do to be able to show you've met the test. The other big piece of it is on the income side of it. Regulated investment companies are required to have 90% what's called 'good income', and good income is the amount that comes from dividend interest, gains, losses, those types of matters. And so if the underlying investment is throwing off other partnership interests or commodity based interest, it may not meet the good income test. And again, for some of these underlying funds or investments that the vehicle might be getting into, it's tough to be able to say the sources of that income in order to be able to show we've met the test. If you fail to meet those tests, you're not considered a regulated investment company, and therefore should have been recording taxes on the funds when you were calculating your net asset values.

**CHUCK JAFFE:** And for individual investors, what that really means is they want to understand the tax situation up front, whether they're getting a 1099 or K-1. Because different tax situations result in not only different taxes but kind of the ease or pain that comes along with filing, right?

**TERRY GALLAGHER:** Absolutely. And that's one of the really big reasons, is trying to get away from the K-1s. Investors don't typically like having to wait to get their K-1 and having to weed through what could be lengthy K-1 information. They like getting the little short 1099 and picking it up for their tax returns.

**CHUCK JAFFE:** One more question for the benefit of those individual investors. We're talking in many cases about unlisted closed-end funds. When something is unlisted, I think the average investor wonders, "Okay, here's this investment opportunity, it's being put together presumably because it's good, but I don't entirely know how to find out about it." Now these are complicated investment vehicles that require in most cases intermediary, but how does somebody say, "Okay, I like the sounds of this. This kind of thinking where I can buy-in, have all of the benefits of the interval style structure, but I don't necessarily know where to find the unlisted ones." How do you point those people in the right direction?

**TERRY GALLAGHER:** These are registered under the Investment Company Act, so are going through the registration process with the SEC. The prospectus information is available either from the fund's website or directly from the SEC. So the information is available, it's really what's trying to offer in many cases now non-traditional investment vehicles to a broader audience. And often those are trying to get returns that are not correlated to the market in general, so looking at investments that aren't following the stock market or the bond market. We've seen a lot of growth in the commercial credit, direct credit market offering fixed-income investments that are a little bit better yielding than straight corporates.

**CHUCK JAFFE:** Terry, really interesting stuff. Fascinating to see how the changes are affecting the industry and the new products are coming out and more. Obviously this is not a trend that's going to stop, so I look forward to chatting with you about it again down the line.

**TERRY GALLAGHER:** Thank you very much, it was good to be with you.

**CHUCK JAFFE:** The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe. I'm Chuck Jaffe, your host, and you can check out

my show on your favorite podcast app or at MoneyLifeShow.com. To learn more about closed-end funds, interval funds, and business-development companies go to AICAlliance.org, the website for the Active Investment Company Alliance. They're on Facebook and LinkedIn @AICAlliance. Thanks to my guest Terry Gallagher, executive vice president at UMB Fund Services, which is online at UMB.com. The NAVigator podcast is available every Friday, please subscribe on your favorite podcast app and join us again next week to learn more about investing with closed-end funds. Until then, stay safe everybody.

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