Simpson Thacher

Registered Funds Alert

June 2018

Table of Contents

The latest edition of Simpson Thacher's Registered Funds Alert discusses recent developments in the registered funds industry, including: answering frequently asked questions regarding the effects of a recent legislative victory for business development companies (BDCs); analyzing the SEC's proposed interpretation of investment advisers' fiduciary duties to clients; suggesting ways that the SEC could better promote self-reporting; and explaining the new "Active Share" metric and the investigation that led to its development.

BDCs Receive Long-Awaited Regulatory Relief—How Does It Work and Is It Enough?

Business development companies ("**BDCs**") recently won a substantial legislative victory that industry advocates have been seeking for years. The Small Business Credit Availability Act (the "**SBCA Act**") was signed into law in March 2018 as part of an omnibus spending bill that will fund the federal government through September 2018. The SBCA Act loosens leverage restrictions and directs the Securities and Exchange Commission (the "**SEC**") to reduce the limitations on security offerings that have historically constrained BDC offerings.

The BDC industry has been advocating for more than five years to secure these changes, which industry participants hope will allow BDCs to lend more money and allow them to compete more aggressively in the U.S. middle-market loan space. Despite the long buildup, the SBCA Act arrived somewhat suddenly when it was added to the omnibus spending bill late in the legislative process, and now industry insiders, observers and investors alike all have questions about the bill, its inner workings, and its practical effects. In this Alert, we address some frequently asked questions regarding the SBCA Act.

Leverage Changes

What were the previous regulatory limits on a BDC's use of leverage?

BDCs have always had the ability to use leverage, albeit limited, as part of their investment strategy. Historically, BDCs have had greater flexibility than other types of registered investment funds—such as traditional closed-end funds and mutual funds—in their use of leverage. Whereas Section 18(a) of the Investment Company Act of 1940, as amended (the "**1940 Act**"), requires registered investment companies to maintain 300% asset coverage for borrowings, which equates to a 1:2 debt-to-equity ratio, Section 61(a) of the 1940 Act requires BDCs to have 200% asset coverage, or a 1:1 leverage ratio (registered closed-end funds have a similar 200% requirement with respect to preferred stock issuances). In other words, a registered investment company can only borrow $50 for every $100 of equity capital on its balance sheet, while a BDC has been permitted to borrow $100 for every $100 in equity. Despite the additional flexibility provided for BDCs, the prior BDC leverage limit is much lower than limits on other lenders that BDCs sometimes compete against. For example, banks and private funds can usually incur significantly higher leverage.

How does the SBCA Act address BDC leverage restrictions, and why does it matter?

While the default leverage limit applicable to BDCs remains the same, the SBCA Act amended Section 61(a) of the 1940 Act to give a BDC the option to effectively double the amount of leverage it may utilize. If a BDC meets certain requirements, the asset coverage requirement applicable to that BDC will be lowered from 200% to 150%, which translates to permitting BDCs to now have up to a 2:1 leverage ratio. Thus, a BDC may now borrow $200 for every $100 in equity capital on its balance sheet.

BDCs have historically felt that the 1:1 leverage limitation was too restrictive and limited their ability to provide much-needed capital to middle-market companies. To generate the types of returns that are attractive to investors with low leverage, BDCs have argued that they were in effect corralled into investing primarily in the riskiest, highest yielding debt. Increasing the leverage limit may allow some BDCs to deploy additional lower-risk senior capital to borrowers and lessen their dependence on the higher-risk junior capital and mezzanine debt in order to obtain consistently attractive yields. For example, an investment that yields 6% using 2:1 leverage could produce roughly the same returns as an investment using 1:1 leverage that yields 9%.

A number of BDCs have utilized various means to obtain effective leverage that exceeds the existing 1:1 limit without the additional leverage counting against the 200% asset coverage requirement. The leverage of certain joint ventures operated by a BDC typically is not counted against the BDC's leverage limit if the joint venture subsidiary is not consolidated for accounting purposes. Similarly, BDCs may own and operate Small Business Investment Companies as subsidiaries, and the leverage of those entities also does not count towards that of the BDC. BDCs can also invest in collateralized debt obligations, which are themselves leveraged.

While the newfound leverage flexibility may be a boon to certain BDCs, not all of them will fully utilize the new leverage limit. Some may not elect to raise their leverage limits, and almost all do not fully utilize the leverage limits available today. According to data from Thomson Reuters, the BDC industry as a whole uses only about $0.69 of debt for every dollar of equity capital, which is significantly less than the 1:1 limitation.

BDCs use less leverage than they are legally permitted for several reasons. Perhaps the most relevant reason is that certain BDCs issue rated debt securities, and ratings agencies typically require a debt-to-equity ratio of less than 0.85 as a prerequisite for an investment-grade rating. Standard & Poor's ("S&P") has publicly stated its view that increased leverage in an already competitive environment may cause a net increase for credit risk for the industry. That ratings agency placed all BDCs it rates on "CreditWatch" with negative implications (and lowered its outlooks to negative on several BDCs). Fitch Ratings did not take any immediate rating actions on BDCs, but the agency said it "generally views the potential leverage increase as a ratings negative."

Even if a BDC were willing to take a potential ratings hit with respect to its future offerings, indentures and other documents relating to its outstanding debt may contain covenants that contractually restrict the BDC from taking actions that negatively impact its creditworthiness or increase its leverage past a certain point. These covenants further impede increases in leverage for BDCs seeking to use the new leverage limit.

Are BDCs automatically able to make use of the higher leverage ratios?

No, the increase in permissible leverage is not automatic and the prior 1:1 limit remains the default standard for BDCs. For a BDC to increase its leverage to the extent permitted by the SBCA Act, it must meet certain requirements. Specifically a BDC may increase its permissible leverage ratio only after: (i) either (A) obtaining the approval of a majority of the BDC's independent directors or (B) obtaining the approval of a majority of shareholders cast at a special or annual meeting where a quorum is present; and (ii) publicly disclosing such approval within five business days and making ongoing disclosures about the increase, the actual amount of leverage utilized and the principal risks associated with the leverage strategy. The required initial disclosure of the approved change would be done through a current report filing on Form 8-K (or other annual or quarterly report) under the Securities Exchange Act of 1934, as amended (the "**Exchange Act**"), which would also be published by the BDC electronically on its website.

The routes to approval are not equivalent. BDCs that seek the ability to increase their leverage ratios through the approval of their independent directors cannot utilize the increase in leverage until one year after the board votes. BDCs that obtain approval via shareholder votes, on the other hand, would be able to increase their leverage past the 1:1 ratio the day after such approval is obtained.

Could a BDC seek both board approval and shareholder approval?

Yes. A BDC could have its board vote on the increased leverage proposal, which is administratively a far simpler task, and then also put the matter to shareholders at a special meeting or the next regularly scheduled annual meeting. In fact, many BDCs are doing just that. The statutory one-year waiting period would begin whenever the board approves the measure. If the shareholders approve the measure at a shareholder meeting, then the BDC would be permitted to make use of the increased leverage the day after. If, however, the board approves the measure but the shareholders do not, the BDC could still make use of increased leverage after the one-year period has tolled, which will be sooner than had they relied solely on obtaining shareholder approval and experience delays in obtaining that approval.

While this two-stage approval approach is permitted under the SBCA Act, it could put the board in the unenviable position of feeling compelled to reconsider relying on the new leverage limit if the proposal is later rejected by the BDC's shareholders. Boards will need to satisfy themselves that, notwithstanding a negative vote (or a failure to achieve quorum), the increase in leverage is supported by prospects for improved performance (and does not result in a disproportionate increase in fees captured by the adviser).

Could a newly formed BDC authorize increased leverage through a sole shareholder vote?

Yes. While nothing in the SBCA Act permits a newly formed BDC to automatically begin operations with a 150% asset coverage ratio, there is also nothing in the SBCA Act that would prevent a sole initial shareholder from voting to approve the ability to rely on the reduced asset coverage requirement. A new BDC would then either include appropriate disclosure in its registration statement regarding its ability to rely on the 150% asset coverage limit or file a Form 8-K within five days if its registration statement is already effective.

Do the SBCA Act's approval provisions overrule any fundamental policy to the contrary?

If a BDC has an existing fundamental policy limiting its use of leverage and then attempts to increase its permissible use of leverage pursuant to the SBCA Act, it is unclear whether merely obtaining board approval would be sufficient. Section 13(a)(3) of the 1940 Act requires shareholder approval to deviate from an existing fundamental policy, but not to adopt a new one that encompasses the old. The SBCA Act's approval procedures do not speak to fundamental policies in general, and so its approval procedures could be read as necessary, but not always sufficient, levels of approval. The question would then be whether the BDC's board allowing the BDC to utilize the increased leverage limit would be "deviating" from a BDC's existing fundamental policy. Such a question can only be answered with reference to the specific policy in question. For example, for a BDC that has a fundamental policy that is tied to compliance with statutory limits, or a fundamental policy to use no more than a specified fraction of the leverage it is permitted to utilize by law, it would not be deviating from that fundamental policy if it continued to abide by the same proportional limitation after changing its leverage ceiling. If, however, the fundamental policy specifies that the BDC will not fall below a certain specified asset coverage ratio (or exceed a certain debt-to-equity ratio), then such an existing fundamental policy would contravene the changes contemplated by the SBCA Act. In that case, it would appear that the BDC would need to receive shareholder approval to effect such a change.[1]

There is potentially an argument based on statutory interpretation that would suggest that Congress intended to create a limited exception to the rules regarding fundamental policies, but it is unclear whether the SEC ultimately would agree. Generally speaking, where there is a clear contradiction between an existing law and a new law, the new law is read to take precedence on matters where the two conflict. For example, in 1996, Congress enacted Section 12(d)(1)(G), which provides that the limitations on funds owning other funds contained elsewhere in Section 12 do not apply if, among other things, the acquired and acquiring companies are part of the same fund group. It did not, however, explicitly make reference to the prohibitions under Section 17 that are also implicated by those transactions. The SEC stated in that case that since Section 12(d)(1)(G) was created to obviate the need for certain fund structures to obtain exemptive relief, continuing to require them to obtain relief for the related Section 17 matters would frustrate the purpose of Congress's actions, so no specific relief with respect to Section 17 would be required for transactions relying on 12(d)(1)(G). Here, that argument is less clear. A BDC would have to make the argument that Congress, in enumerating the specific approval procedures with respect to the leverage ratio changes, intended to put aside other additional mechanisms of shareholder protection with respect to the leverage issue. If that were the case, then the requirement that any BDC with a fundamental policy restricting leverage must still obtain shareholder approval before deviating from that fundamental policy would frustrate Congress's intent.

Are there any other protections for existing BDC shareholders with respect to the leverage changes?

As mentioned above, if a BDC elects to increase its maximum leverage ratio by obtaining the votes of a majority of its independent directors, a one-year waiting period is required before the BDC can begin to utilize the increased leverage. The one-year period is intended to allow shareholders who disagree with the increase in leverage to sell their stake in the BDC.

In addition, if an unlisted BDC approves an increase in its leverage ceiling, it is required to offer its existing shareholders some form of liquidity. Regardless of whether a BDC approves the leverage change through a board vote or a shareholder vote, if its common shares are not listed on a national exchange, the BDC must extend to each person that is a shareholder as of the date of the approval the opportunity to sell the BDC shares held by that shareholder as of the approval date.

If a shareholder accepts the offer, the BDC would be required to repurchase 25% of that shareholder's eligible shares each quarter of the four calendar quarters following the quarter in which the leverage change was approved. While most non-traded BDCs have some mechanism for offering shareholders periodic liquidity, many private BDCs do not, and the only planned liquidity events are dissolution or a future listing at some point in the future. Having to

1. Consider, for example, that when the SEC adopted Rule 35d-1, which in effect required certain funds to change their fundamental investment policies to require portfolios to be invested at least 80% in investments implied by the name of the fund to avoid misleading investors, the SEC noted that funds required to make changes to fundamental policies might be required to obtain shareholder approval if a preexisting fundamental policy conflicted with the new rule requirement. *See* https://www.sec.gov/divisions/investment/guidance/rule35d-1faq.htm#P23_1077.

deal with a forced liquidity event may dramatically impact such private BDCs, to the point where it might be untenable for them to enact the leverage change.

Are lenders likely to extend additional credit to BDCs that increase their leverage?

Generally, yes, but each BDC is situated differently. The borrowing ability of a BDC with a well-established track record that invests primarily in senior loans is very different from the borrowing ability of a newly created BDC that proposes to invest primarily in mezzanine loans. The industry focus, investment strategy and proven access to deals will also impact the ability of a given BDC to borrow.

Historically, in part because BDCs have been required to maintain relatively low leverage ratios, credit rating agencies have considered BDCs to have good credit quality and they have been viewed as attractive borrowers by traditional banks and bond markets. Banks have reliably lent BDCs money at much lower interest rates than the rate of return BDCs expect to earn from their investments. Bank debt has historically been cheaper to BDCs, and so, if as discussed above, ratings agencies and banks revise down their view on the creditworthiness of higher-leveraged BDCs, such changes likely will increase the cost of borrowing for those BDCs.

Even if traditional borrowing costs increase, it's unlikely that most BDCs would find themselves entirely unable to access additional credit. Because they are statutorily required to maintain a set asset coverage ratio, if the BDC breaks that limit, it is required to suspend dividends and sell assets until it is in compliance with the asset coverage requirement. This generally protects creditors, even if it is at the expense of shareholders. Furthermore, all BDCs, including non-traded and private BDCs, are required to make public disclosures akin to those of a public company. As a result, lenders have better access to financial information on a quarterly basis and can take comfort in the fact that the financials of the BDC are subject to the scrutiny of the public and the SEC.

Security Offerings

What does the SBCA Act change about securities offerings by BDCs?

The SBCA Act requires the SEC to amend a number of rules and forms so as to allow BDCs access to various accommodations to the rules and regulations regarding the registration, communications and offering processes for registered transactions under the Securities Act of 1933, as amended (the "**Securities Act**"), that BDCs and registered investments companies, including traditional closed-end funds, have thus far been excluded from using. The changes will treat BDCs like other non-investment company issuers that perform registered offerings and streamline the offering process.

What does the SBCA Act change about BDC shelf registrations?

While BDCs have been permitted to use shelf registration statements on Form N-2 to register multiple offerings of securities in order to raise capital, currently those filings do not automatically become effective. This stands in contrast to the shelf registration process available under Form S-3, which permits shelf registration statements of "well-known seasoned issuers" ("**WKSIs**") to be automatically effective upon filing. Automatically effective registration statements provide flexibility for WKSIs to time securities sales with optimal market conditions without waiting for the SEC staff to review and comment on a registration statement and declare it effective. BDCs, along with registered investment companies, were expressly excluded from the statutory definition of a WKSI, pursuant to Rule 405 of the Securities Act.

The SBCA Act revises the definition of WKSI to make that status available to certain BDCs. The law removes the exclusion of BDCs from the definition of WKSI and adds registration statements filed by BDCs on Form N-2 to the definition of "Automatic Shelf Registration Statement." For those BDCs that will qualify as WKSIs,[2] this change will dramatically

2. To qualify as a WKSI, a BDC must (i) have been an SEC-reporting company for at least 12 calendar months and have filed all material required to be filed with the SEC in a timely manner over the preceding 12 calendar months; (ii) have not had any material defaults on indebtedness or longterm leases since the end of the last fiscal year; (iii) either have (A) a worldwide float of at least $700 million (i.e., market value of outstanding voting and nonvoting common equity held by non-affiliates) or (B) issued for cash during the past three years at least $1 billion in aggregate principal amount of non-convertible debt securities in primary offerings registered under the Securities Act and; (iv) not be an "ineligible issuer," as that term is used in the Securities Act, or an asset-backed issuer.

reduce the costs associated with starting and supporting shelf offering programs.

What does the SBCA Act change about incorporation by reference for BDCs?

Form S-3 allows a company to incorporate by reference the disclosure from its current and future Exchange Act reports to satisfy the disclosure requirements of the Form. Incorporation by reference occurs when disclosure in one filed document is legally deemed to be included in another document. Currently, Form N-2 does not allow for periodic reports to be incorporated by reference. The SBCA Act requires the SEC to amend Form N-2 to permit a BDC that has been an Exchange Act reporting company for 12 months and has a $75 million common share public float to incorporate by reference current and future publicly filed periodic reports into their registration statements. These changes should streamline the registration process for BDCs by making it less cumbersome to maintain a current shelf offering document and reduce the bulk of offering documents generally.

The SBCA Act also directs the SEC to amend the rules under the Exchange Act to allow a BDC to incorporate previously filed financial statements into its proxy materials under Schedule 14A, similar to what is permitted under Form S-3.

The SBCA Act also requires the SEC to revise Rule 497 of the Securities Act to allow a BDC to file a form of prospectus that contains substantive changes from or additions to a previously filed and effective base prospectus similar to how non-investment company issuers file such supplements under Rule 424(b).

What does the SBCA Act change about prospectus delivery for BDCs?

The SBCA Act extends "access equals delivery" treatment to BDCs. BDCs are currently often required to deliver a final prospectus to each purchaser by printing and mailing hard copies to investors. "Access equals delivery" under Rule 172 under the Securities Act, which deems electronic availability of the prospectus equivalent to physical delivery in certain circumstances, previously was unavailable to BDCs. The SBCA Act requires the SEC to adopt rules bringing parity to BDCs in this regard, and will allow BDCs to provide a notice of registration in lieu of sending the final prospectus. These changes should significantly reduce the cost and burden associated with prospectus delivery.

What does the SBCA Act change about market communication for BDCs?

Currently, BDCs are not eligible to rely on certain safe-harbors contained under Rules 134, 163, 163A, 168 and 169 under the Securities Act, which permit issuers to release certain factual and forward-looking business information under certain safe harbors from the Securities Act's gun-jumping provisions and other restrictions. The SBCA Act directs the SEC to allow BDCs to utilize these rules, which should permit BDCs to more easily communicate with the market. Similarly, the SBCA Act directs the SEC to modify Rules 138 and 139 which will permit broker-dealers and other providers of market research more flexibility to disseminate research on BDCs and thereby further enhance communication to the market regarding BDCs.

> *"Individually and in the aggregate, the SBCA Act's modifications to BDC offering rules will make it quicker and easier for BDCs to raise capital through registered offerings."*

These changes, in conjunction with the other offering-related changes discussed above, align the rules governing BDC offering communications with the more permissive rules available to operating companies. Individually and in the aggregate, the SBCA Act's modifications to BDC offering rules will make it quicker and easier for BDCs to raise capital through registered offerings.

When will BDCs be able to take advantage of the registered offering-related changes?

The SBCA Act directs the SEC to effect the changes described above by March 23, 2019. BDCs will not be able to take advantage of the securities offering changes until the date the SEC takes the directed actions. If the SEC fails to act to revise the rules and forms as directed within the window provided by the law, however, the SBCA Act permits BDCs to treat such revisions as having been made in accordance with the specifications set out for the SEC within the SBCA Act, until such time as the SEC adopts the directed revisions.

Are the SBCA Act's reforms everything BDCs need to reach their full potential?

While the SBCA Act's reforms are welcomed and important changes for the BDC industry, there are other problematic rules that BDCs need reprieve from before they can reach their full potential. Perhaps the clearest example of a regulatory issue that still needs to be addressed is the requirements governing acquired fund fees and expenses ("**AFFE**"). The AFFE rules require 1940 Act funds that invest in BDCs to include the BDC's expenses in their own funds' expense ratios. The application of this disclosure requirement to BDCs distorts and overstates the expenses of mutual funds and other registered funds when those funds invest in BDCs.

The rationale for AFFE does not make much sense in the context of listed BDCs. When an acquiring fund purchases shares in a mutual fund, for instance, those shares are purchased at the target fund's NAV. The NAV reflects the value of the portfolio asset but does not effectively capture the present value of the future management fees, and these future management fees will represent a reduction in the investor's returns. The AFFE rule is supposed to force the acquiring fund to disclose this to the investors by disclosing the target fund's expense ratios alongside their own. When an acquiring fund purchases a listed BDC, however, it does so at the BDC's market price, and that price theoretically does account for future expenses. Given that the BDC's trading price will already reflect its operating expense structure, reflecting the operating expenses again under the AFFE rule results in the double-counting of the target BDC's expenses. Accordingly, the AFFE rule disclosure requirements result in acquiring funds significantly overstating their own expense ratios, which of course makes BDCs dramatically less attractive investments for mutual funds and other registered funds.

The AFFE disclosure rules have effectively resulted in a ban on BDCs from most indices. Since many institutional investors use indices to guide their investment strategies (including tracking an index), the AFFE disclosure rules made it problematic for the operators of indices to continue including BDCs. In 2014 the MSCI, Russell and S&P indices all removed BDCs from their respective indices primarily because of the AFFE rule disclosure requirement.[3] The trend of steady growth in the number of public BDCs for more than a decade prior to 2014 flattened following the change, as has institutional ownership of BDCs. However helpful the SBCA Act is, if Congress and the SEC truly want to see BDCs live up to their full potential, their work is not yet done—addressing the AFFE roadblock would be a great next step.

Proposed Interpretation of Adviser Duties Flies Under Radar Next to Headline-Grabbing Broker-Dealer Proposals

The SEC issued three highly anticipated and significant proposals earlier this year that have the potential to significantly alter the regulation of broker-dealers and investment advisers. These proposals address enhanced standards of conduct for broker-dealers and propose an interpretation clarifying the fiduciary duty owed by investment advisers. In the aftermath of the United States Court of Appeals for the Fifth Circuit's decision to vacate the Department of Labor's "fiduciary rule," the SEC's proposals have been widely followed by broker-dealers and advisers looking for clarity as to the scope of their duties and liabilities. During the open meeting to consider these proposals, the SEC's commissioners expressed a healthy range of views and concerns, but in voting four to one in favor of submitting the proposals for public comment the commissioners signaled to broker-dealers and advisers that they recognize the uncertainties surrounding fiduciary standards and are willing to take substantial steps towards transparency.

The first proposal, "Proposed Interpretation Regarding Standard of Conduct for Investment Advisers; Request for Comment on Enhancing Investment Adviser Regulation," interprets the SEC's views of the fiduciary duties advisers owe their clients and requests comments on whether

3. *See*, e.g, https://www.fitchratings.com/gws/en/fitchwire/fitchwirearticle/Removal-of-BDCs?pr_id=823651(discussing the rationales for removing BDCs from indices and its potential effects on those BDCs).

the SEC should propose rules to impose certain licensing, continuing education, and other FINRA-like obligations on advisers. The second proposal, "Regulation Best Interest," would require a broker-dealer to act in a retail customer's best interest when it makes securities recommendations—i.e., the proposed regulation is designed to prohibit a broker-dealer from putting its financial interests ahead of its retail customers. The third proposal, "Form CRS Relationship Summary; Amendments to Form ADV; Required Disclosures in Retail Communications and Restrictions on the use of Certain Names or Titles," would mandate that advisers and broker-dealers provide retail customers with summary information about the nature of the client relationship, and would restrict certain broker-dealers from using the terms "adviser" or "advisor" as part of their name or title when dealing with retail customers.

This Alert focuses on the SEC's interpretation of advisers' standard of care, but the importance of the proposals relating to broker-dealer duties and disclosure applicable to retail investors cannot be overstated in light of the SEC's effort to enhance the quality and transparency of retail investor relations.

Standard of Conduct for Investment Advisers

The SEC's proposed interpretation reaffirms and clarifies certain standards of conduct applicable to advisers under the Investment Advisers Act of 1940 (the "**Advisers Act**"). The federal fiduciary standard for advisers under the Advisers Act comprises two broad duties: the duty of care and the duty of loyalty. The identity of fiduciaries and the scope of their responsibilities are sometimes open to debate. The Department of Labor's attempted fiduciary rule did not succeed in establishing clear fiduciary standards, but, with a few exceptions, the SEC's proposal does. Our thoughts on the SEC's interpretation of advisers' duty of care and duty of loyalty are summarized below, including a key criticism related to the SEC's apparent view regarding how advisers allocate investments across multiple eligible client accounts.

> *"The federal fiduciary standard for advisers under the Advisers Act comprises two broad duties: the duty of care and the duty of loyalty."*

Duty of Care

According to the proposal, an adviser's duty of care to a client includes, among other things: (i) the duty to act and to provide advice that is in the best interest of the client; (ii) the duty to seek best execution of a client's transactions where the adviser has the responsibility to select broker-dealers to execute client trades; and (iii) the duty to provide advice and monitoring over the course of the relationship.

(i) Duty to Provide Advice that is in the Client's Best Interest

When providing personalized investment advice, the duty of care requires that an adviser make a reasonable inquiry into a client's financial situation, level of financial sophistication, investment experience and investment objectives, which the proposal refers to as the client's "investment profile." Understanding a client's investment profile allows an adviser to provide suitable advice that is consistent with the best interests of the client. Advisers typically engage in suitability analyses when allocating investment opportunities amongst client accounts. The proposal establishes a reasonableness standard to assess an adviser's inquiry into its clients' investment profiles, the nature and extent of which turn on what is reasonable under the circumstances, including the agreed-upon advisory services, the complexity of the anticipated investment advice and the investment profile of the client.

The proposal notes that, when allocating investments, advisers should consider a client's risk tolerance and the costs of such investments (among other things). Contrary to the belief that swept through the industry and contributed to the proliferation of "clean shares" after the Department of Labor's fiduciary rule was adopted, the SEC's proposal recognizes that context matters and notes that the duty of care does not require that an adviser recommend the lowest cost investment to its clients. However, the proposal qualifies this statement by explaining that the SEC's view is that an adviser could not reasonably believe that a security is in the best interest of a client if it has a higher cost than a security that is otherwise identical. The proposal notes that, if an adviser advises a client to invest in a mutual fund share class that is more expensive than other available options when the adviser is receiving compensation that creates a potential conflict and that may reduce the client's return, the adviser may violate its fiduciary duties and the antifraud provisions of the Advisers Act if it does not, at a minimum, provide full and fair conflicts disclosure and obtain informed consent to such conflicts. The interpretation recognizes that a more expensive product's suitability depends on a client's investment profile and the context in which the adviser manages the portfolio. For example, it could be consistent with an adviser's fiduciary duty to advise a client with a high risk tolerance and significant investment experience to invest in a private equity fund with relatively higher fees if other factors, such as diversification and potential performance benefits, support the investment as being in the client's best interest.

(ii) Duty to Seek Best Execution

The proposal provides that an adviser's duty of care extends to its selection of broker-dealers to execute client trades. The proposal describes "best execution" to mean a client's total cost or proceeds from a transaction must be the most favorable under the circumstances. An adviser fulfills this duty by executing transactions with the goal of maximizing value for the client under the given circumstances, and the SEC recognizes that maximizing value entails more than minimizing cost.

In seeking best execution, the proposal notes that advisers should consider the full range and quality of a broker's services, including the value of research provided. Institutional advisers commonly use soft dollar credits to execute trades with broker-dealers in exchange for research; there is no indication the SEC intends to reign in this practice by viewing execution costs in a vacuum.

(iii) Duty to Act and to Provide Advice and Monitoring Over the Course of the Relationship

Asserting a perpetual nature of the duty of care, the proposal states that an adviser must provide advice and monitoring over the course of the client relationship at a frequency that is in the best interest of the client and consistent with the scope of the agreed-upon advisory services. The proposal highlights this duty for advisers that have ongoing client relationships, specifically referencing advisers that are compensated with a periodic asset-based fee (as opposed to transaction-based fees) or that have discretionary authority over client assets, which generally applies to advisers to registered funds.

Duty of Loyalty

The proposal interprets the duty of loyalty broadly to require that an adviser put its clients' interests ahead of its own and refrain from unfairly favoring one client over another. To meet this duty, the proposal provides that an adviser must make full and fair disclosure to its clients of all material facts relating to the advisory relationship and all material conflicts that could affect the advisory relationship. The prominence of conflicts disclosure in the interpretation reaffirms that an adviser's duty to avoid conflicts with its clients and, at a minimum, disclose such conflicts is a cornerstone of the duty of loyalty. The proposal further states that advisers need to describe conflicts with sufficient specificity to give investors the ability to provide informed consent. This is not a new concept, but that statement will further empower examiners to push for more specificity in conflicts disclosure. The proposal notes that disclosing the mere possibility of a potential conflict is not adequate when such conflict actually exists, a point which was emphasized at the SEC's annual Compliance Outreach Program National Seminar in April 2018.[4] As such, advisers may wish to consider amending their Form ADV brochures and other sources of conflicts disclosure to disclose conflicts in definite terms rather than in the abstract.

The proposal interprets the duty of loyalty to include a duty not to treat some clients favorably at the expense of other clients. Thus, when allocating investment opportunities among eligible clients, the proposal said that an adviser must treat all clients fairly. We note that the proposal stops short of saying that clients must be treated "equally." Without further guidance as to the SEC's definition of "fairly," the proposal could be interpreted to prohibit the common practice among advisers to allocate specific investment opportunities to clients with priority rights on certain types of investments, even though other clients might have eligible investment profiles. The proposal cites to an article that provides that an adviser must not give preferential treatment to some clients or systematically exclude eligible clients from participating in specific opportunities without providing the clients with the appropriate disclosure regarding the treatment. The proposal further notes that an adviser's allocation policies must be fair and, if they present a conflict, the adviser must fully and fairly disclose such conflict that a client can provide informed consent.[5] The proposal stops short of deeming it permissible to exclude certain clients from investments if the adviser has disclosed its practice to do so, but by citing to this article, it may have incorporated this position by reference.

An adviser's conflicts disclosure should include a clear methodology for allocating investment and disposition opportunities across multiple eligible client accounts. It is not uncommon for such

4. The SEC has found an adviser's disclosure inadequate because it stated the adviser may receive compensation from a broker as a result of facilitating client transactions through the broker and that these arrangements may create a conflict of interest when the adviser was actually receiving such payments and had such a conflict. *See* In the Matter of The Robare Group, Ltd., et al., Investment Adviser Act Release No. 4566 (Nov. 7, 2016).

5. This requirement is consistent with an advisers' responsibility to maintain policies and procedures that address allocation of investment opportunities and disclosure, and to provide clients with sufficiently specific facts so that the client is able to understand the adviser's conflicts of interest and give informed consent to such conflicts or reject them. *See* Investment Advisers Act Release No. 2204 (Dec. 17, 2003); General Instructions for Part 2 of Form ADV.

methodologies to contemplate strategic relationships with individual clients, other third parties or affiliates that provide for preferential "first rights" on certain investments or categories of investments. An otherwise eligible client may be excluded from an investment opportunity if an adviser has such a strategic relationship. The proposal's fairness standard does not necessarily conflict with first-rights allocation methodologies. Advisers may enter into strategic relationships for a variety of reasons, including to receive referrals, reliable liquidity and reciprocal first rights. Preferential allocations are not inherently "unfair" (when clearly disclosed), as the benefits of strategic relationships are generally shared among clients, but we expect continued uncertainty on this point without further clarification from the SEC.

The SEC's Share Class Selection Self-Reporting Initiative: A Creative Idea That Should Go Further

The SEC recently has focused on what it perceives as disclosure violations related to how registered investment advisers select mutual fund share classes for their clients. In this Alert, we discuss a recent initiative by the SEC to encourage self-reporting of such violations and highlight ways the SEC could better incentivize self-reporting in the future.

Continuing a theme from 2017, the SEC's Office of Compliance Inspections and Examinations ("**OCIE**") has stated that it will continue to focus on share class disclosure violations in its exam priorities for 2018. To that effect, the SEC Division of Enforcement (the "**Enforcement Division**") launched a new initiative on February 12, 2018—the Share Class Selection Disclosure Initiative ("**SCSD Initiative**"). The SCSD Initiative provides a self-reporting outlet for firms that have failed to adequately disclose conflicts of interest related to the selection of mutual fund share classes that paid the adviser as a dually-registered broker-dealer, or its related entities or individuals, compensation when a lower-cost share class for the same fund was also available to the adviser's clients. The SEC believes these violations are widespread and that the SCSD Initiative is a better allocation of agency resources than individualized enforcement actions. On May 1, 2018, the SEC published frequently asked questions (FAQs), providing additional information about the SCSD Initiative.

Further underscoring the SEC's focus on this issue, the SEC announced settlements with three advisers—PNC Investments LLC, Securities America Advisors, Inc. and Geneos Wealth Management—for failing to disclose that they invested clients in share classes with Rule 12b-1 fees when cheaper shares of the same fund with lower Rule 12b-1 fees or no Rule 12b-1 fees were also available.[6] The SEC ordered each firm to pay a fine, along with disgorgement and interest.

Background

The SCSD Initiative is intended to be a reporting mechanism for advisers who have failed to make what the SEC views as necessary disclosures regarding Rule 12b-1 fees. The Advisers Act provides that advisers have a fiduciary duty to disclose to clients conflicts of interest which may lead an adviser, whether intentionally or not, to render investment advice that is not disinterested. The SEC asserted that advisers often recommend share classes with Rule 12b-1 fees over share classes of the same fund with lower fees in order to increase their revenue. Rule 12b-1 fees are paid by mutual funds to an adviser on an ongoing basis from the fund's assets, thereby reducing a shareholder's returns. As such, when a share class with no Rule 12b-1 fee or a lower Rule 12b-1 fee is available for the same fund, it is usually in a shareholder's best interest to invest in the lower-cost share class. Advisers are required to disclose conflicts of interest, such as this, and receipt of Rule 12b-1 fees on Form ADV. The SEC believes this lack of disclosure is prevalent in the mutual fund industry.

6. The FAQs provide examples of what it means for a lower-fee share class to be "available", including when: a client could have purchased a lower-cost share class for the same fund because the client's investment met the applicable investment minimum; according to a fund's prospectus, the fund would waive the investment minimum for a lower-cost share class for the same fund for advisory clients and the adviser had no reasonable basis to believe the fund would not waive the investment minimum for a lower-cost share class for its clients; and the adviser purchased a lower-cost share class of the same fund for other similarly-situated clients.

Consequences of Self-Reporting

Advisers had until June 12, 2018 to self-report. If an adviser elects to self-report under the SCSD Initiative, the adviser must disclose both the conflict associated with making investment decisions in light of the receipt of 12b-1 fees and the conflict associated with selecting the more expensive Rule 12b-1 fee paying share class when a lower-cost share class was available for the same fund. In exchange for self-reporting, the Enforcement Division has stated that it will recommend favorable and standardized settlement terms. The standardized settlement terms involve:

- A cease and desist order under Sections 203(e) and 203(k) of the Advisers Act for violations of Sections 206(2) and 207 of the Advisers Act based on the adviser's failure to disclose the conflict of interest, along with a censure;
- Disgorgement by the adviser of its ill-gotten gain, as reported on the self-reporting questionnaire and as discussed with the Staff, and prejudgment interest on such gain, which may be offset in the Staff's discretion if it determines that the adviser reduced or offset its advisory fee by the amount of the Rule 12b-1 fees;
- A certification that the disgorgement is accurate and an order requiring the adviser to make an adviser-administered distribution to affected clients; and
- An acknowledgement that the adviser has taken certain steps to remedy the violation or an order of undertakings requiring that within 30 days of instituting the order, the adviser will take such steps.

The FAQs also highlighted two interesting features of the SEC's approach to this issue. To provide advisers with certainty regarding the consequences of self-reporting, the SEC emphasized that "the severity and scope" of the conduct will not significantly change the terms that the SEC would seek to impose in connection with a settlement. Additionally, unlike the recent settlements noted above, any settlements recommended by the Enforcement Division under the SCSD Initiative will not involve civil penalties. However, under Section 203(e) of the Advisers Act, cease and desist orders require firms to agree to a "willful" violation of the Advisers Act.[7] To date, no settlements have been issued pursuant to the SCSD Initiative.

7. A finding of a willful violation does not require that an actor knows he or she is violating a federal security law.

True Amnesty?

While the SCSD Initiative seemingly provides a rare safe opportunity for advisers who may have failed to disclose conflicts of interest regarding Rule 12b-1 fees, the extent of its protection is limited. Any other potential misconduct discovered throughout the course of an SCSD Initiative self-reporting investigation is not subject to the same leniency as a failure to disclose Rule 12b-1 fees, which the SEC reiterated in the FAQs. Further, the SCSD Initiative only applies to advisers. If individuals associated with the advisers have engaged in any violations of the securities laws, the SCSD Initiative will not cover these individuals.

An adviser who self-reports will inevitably face an SEC enforcement action, which may be disruptive to the adviser's business and harmful to its reputation. The primary upside to self-reporting is that the Enforcement Division would not recommend a civil monetary penalty in connection with such an enforcement action. Fearing the peripheral consequences of an enforcement action and public sanctions, many advisers may, on balance, be deterred from self-reporting despite the standardized settlement terms.

Suggested Enhancements to a Self-Reporting Mechanism

The SEC could promote much greater levels of self-reporting if it lessened the potential collateral effects that an enforcement action may have on an adviser and its business. To encourage self-reporting, whether related to Rule 12b-1 fee disclosure or other issues, the SEC should consider taking an alternative approach with less severe consequences. In the past, the SEC has from time to time decided to take no enforcement action at all if a registrant self-reported. In a 2001 report investigation, the SEC emphasized that one of the factors it considered in not recommending an enforcement action was that the company self-reported its misconduct. Currently, the odds of an adviser avoiding an enforcement action are better if the adviser does not self-report. If the threat of an enforcement action was a less certain result of self-reporting, advisers may be more willing to initiate a dialogue with the SEC regarding potential violations.

Another potentially viable alternative to the current self-reporting regime may include solutions comparable to non-prosecution agreements or deferred prosecution agreements. Non-prosecution agreements are entered into in limited circumstances in which the SEC agrees not to pursue an enforcement action against an individual or company if they agree to cooperate fully and truthfully and comply with express undertakings, while deferred prosecution agreements also require that an individual or company comply with express prohibitions *and* undertakings during a specified period of time. While these agreements typically are entered into with respect to criminal conduct, the SEC should consider similar leniency under its self-reporting programs to better incentivize advisers to participate.

Conclusion

The SEC should be applauded for its creativity in launching the SCSD Initiative. It presents a rare opportunity for advisers to self-report violations of the securities laws with reasonable certainty as to the consequences that the SEC will impose. On the other hand, the consequences of self-reporting, and all of the attendant intangible harms to an adviser's business and reputation, may outweigh the benefits of such certainty to advisers considering whether to self-report. The SEC should consider alternatives to sanctions in order for the SCSD Initiative, as well as similar future initiatives, to better encourage participation and remove the incentive for advisers to sweep minor violations under the rug.

New York Attorney General's Investigation Into Actively Managed Mutual Funds Leads to Enhanced Disclosure to Retail Investors

In April 2018, the Investor Protection Bureau of the Office of the New York Attorney General ("**NYAG**") released its findings and recommendations following an investigation into mutual fund fees. The investigation resulted in pressure on mutual fund firms to disclose to retail investors more information about just how "active" their management is with respect to actively managed funds. Specifically, the NYAG reached an agreement with several large mutual fund firms in which the firms agreed to publicly publish a metric known as "Active Share." This metric purports to measure the difference between a mutual fund's holdings and the holdings of its benchmark index based on the number of issuers and the weight of each holding in the fund's portfolio compared to the weight of each holding in the benchmark's portfolio.

The NYAG's initiative reflects two significant trends in the asset management industry: (i) state governments stepping in to regulate the industry, claiming that the SEC is abdicating its role; and (ii) the battle between active and passive funds for retail investments. In support of this Active Share campaign, now-former Attorney General Eric Schneiderman stated that public disclosure of this new metric will allow retail investors to make more informed decisions prior to investing in a mutual fund by helping them determine if a fund's high fee is appropriate based on its level of active management. Although the NYAG insists that the Active Share metric is a necessary tool, it is unclear how retail investors will actually benefit from this disclosure. Indeed, there is a risk that investors may end up putting too much emphasis on the Active Share metric at the expense of other relevant factors that influence a fund's fee rate.

The NYAG was prompted to conduct this industry-wide investigation due to the popularity of actively managed mutual funds despite the fact that they charge higher fees than passively managed mutual funds. As part of its investigation, the NYAG surveyed several mutual fund firms that manage more than 2,000 actively managed mutual funds. The survey sought to determine whether and how these firms use the Active Share metric, and whether the Active Share metric is publicly disclosed to investors. The NYAG found that every surveyed firm used the Active Share metric in some capacity—including measuring risks for an individual fund, setting informal targets for portfolio managers, selecting and assessing performance of portfolio managers and sub-advisers—and that every firm disclosed Active Share information to institutional investors in presentations or pitch books (or at least upon request). In contrast, the NYAG found that only four of the 14 surveyed firms provided any Active Share information to their retail investors, either on the firm's website or in supplemental data sheets posted online.[8]

Following the NYAG's investigation, all of the surveyed firms that were not already publishing Active Share data have agreed to publish the information on their websites for their actively managed mutual funds. Although the NYAG's recommendation did not include a compliance date for mutual fund firms, this disclosure should soon, if not already, be available to U.S. investors.[9] The NYAG urged all mutual fund firms to follow suit and recommended that retail investors take advantage of this new information when deciding whether an actively managed mutual fund's fee is acceptable

8. The report noted that some firms provided the Active Share information to retail investors through brokers and other intermediaries, but only upon request.

9. Eight of the firms have already published their Active Share data either on their website, through a fund fact sheet or in a quarterly statistic report for each relevant fund.

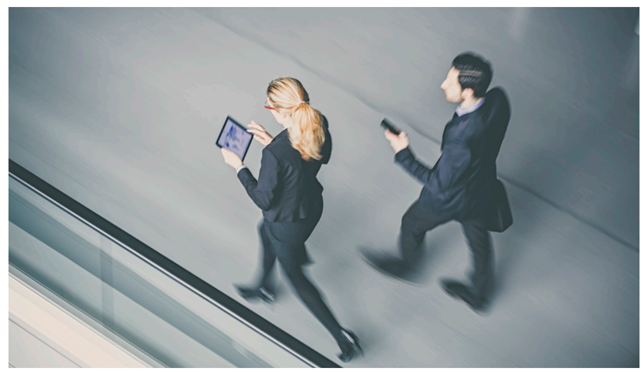
based on the level of the fund's overlap with its benchmark.

The investigation is part of a long history of state governments getting involved in regulating the mutual fund industry

In its politically charged report, the NYAG explained that it was prompted to conduct its investigation in part because of the increasing complexity surrounding mutual fund market and the NYAG's view that the federal government has rolled back protections designed to heighten the duty of care owed to investors and address investment advisers' conflicts of interest. Specifically, the NYAG's report noted the uncertainty concerning the future of the Department of Labor's Fiduciary Rule, including the inconsistent decisions from federal appellate courts regarding the validity of the rule and the Trump administration's decision to delay the enforcement of the rule until July 2019. The report also noted the SEC's inaction with respect to implementation of a uniform best interest standard.[10] The NYAG believes that pervasive, unaddressed conflicts of interest, especially in the retirement advisory business, could cost investors between $95 billion and $189 billion over the next 10 years. In light of these issues, the NYAG believes that disclosing Active Share information will give retail investors the tools they need to be more vigilant in evaluating investment choices and recommendations from their investment advisers. Assuming for the sake of argument that the claim of harm is true, it is difficult to understand how Active Share disclosure would cure it.

State governments' involvement in regulating the asset management industry is not novel. Beginning in 2003, Eliot Spitzer, New York's Attorney General at the time, investigated several mutual fund and hedge fund firms in an attempt to crack down on alleged widespread illicit trading practices, specifically late trading and market timing. The probe ultimately resulted in settlements with a number of firms. Mr. Spitzer's findings from these cases also convinced both the SEC and the Commonwealth of Massachusetts to launch their own investigations into hedge fund and mutual fund practices, and the SEC agreed to work with Spitzer on his probe. Also at that time, William F. Galvin, the Massachusetts Secretary of the Commonwealth, launched a joint inquiry with Mr. Spitzer into a firm's sale of proprietary mutual funds to investors who were not aware that brokers received additional compensation for selling such funds, which ultimately led to a settlement. The inquiry not only focused on the firm's practice, but also sought to determine if other firms had similar practices. Commentators at the time asserted that the SEC was lagging Mr. Spitzer's aggressiveness with investigating conflicts of interest in the asset management industry, although the SEC insisted that it had not been made aware of these allegations until Mr. Spitzer filed his complaints.

Given assertions by certain state regulators that the Trump administration is seeking to roll back and/or halt the federal regulatory process, state governments likely will seek to increase efforts to extend their authority over the asset management industry and could cause significant headaches and burdens for the industry if responding to inquiries from a patchwork of state regulators.



The investigation reflects the ongoing battle between passively managed and actively managed mutual funds

Another major factor that the NYAG claimed prompted its investigation into the mutual fund industry was a desire to better understand whether actively managed funds' significantly higher advisory fees correlate with higher levels of active management. The NYAG found that actively managed funds cost 4.5 times more than passively managed funds. The NYAG compared each fund's Active Share metric to its advisory fee and discovered that funds charged a wide range of fees for the same level of active management. The NYAG concluded that investors could not assume that the higher fees reflected the funds' opportunity to outperform their benchmarks through more active management. The NYAG's comparison, however, contains a flawed assumption (discussed further below) that the only way to outperform a benchmark is to have little overlap with it.

The NYAG's report highlights the ongoing battle between passively managed and actively managed funds for investors' dollars. The NYAG's report noted that by 2016, nearly half of all U.S. households

10. The NYAG report predated the SEC's recent proposals regarding the standards of care for broker-dealers and investment advisers, which are discussed elsewhere in this Alert.

invested in mutual funds, either directly or indirectly through an employer's 401(k) plan. Although most investors choose to invest in passively managed funds, actively managed funds still remain a popular option for investors looking for an opportunity to outperform a benchmark, despite the higher fees charged for such funds. Some critics, however, believe that some actively managed mutual funds are merely index funds in disguise. At this point, it is unclear how much weight investors put on the Active Share metric and whether this new disclosure will impact actively managed fund flows.

The Active Share metric is unlikely to be as informative for retail investors as the NYAG expects

Although the NYAG concluded that disclosure of Active Share information is critical to close the information gap that hinders retail investors' ability to make informed investment decisions, the disclosure of Active Share information in practice likely is not as informative as the NYAG believes. In the NYAG's view, investors cannot look at a mutual fund's advisory fee alone to determine its level of active management and, in turn, its potential to generate better returns compared to its benchmark or avoid losses. The NYAG's report recommends that retail investors use the Active Share metric when evaluating investment options, but fails to explain how investors should use this information and does not recommend that investors view the Active Share metric as only one of a number of factors relevant to evaluating a mutual fund.

Despite the level of importance the NYAG attached to the Active Share metric, its agreements with the mutual fund firms only require this metric to be updated quarterly, as opposed to daily. As such, the Active Share metric is only providing retail investors with a snapshot of the mutual fund's active management at one point in time, which is unlikely to paint an accurate picture of the actual extent of active management for a fund. Certain mutual fund firms may decide to publish more frequent Active Share information or historical Active Share information, either in the spirit of transparency or in order to highlight their active management to retail investors. In addition, the NYAG's report only acknowledges that the Active Share metric may be less relevant when comparing different types of mutual funds, such as those with different market-caps. It does not recognize that the Active Share metric may be far less useful for funds with flat benchmark indexes, such as the Russell 2000, or when comparing funds that utilize different strategies in their active management (e.g., sector, geographic or momentum strategies). It remains to be seen if retail investors will actually appreciate these limitations of the Active Share measure.

Finally, too much emphasis on the tenuous link between the Active Share metric and investment advisory fees may encourage plaintiffs to pursue frivolous excessive fee lawsuits. While the NYAG's report appears to suggest that a high advisory fee for an actively managed fund is not justified if the fund has a low Active Share metric, a fund's advisory fee involves many other considerations beyond the amount of active management, such as the level of complexity involved with a particular strategy. If investors do not appreciate the intricacies involved in setting a fund's advisory fee, they may jump to the conclusion that a high advisory fee is not warranted based solely on the Active Share metric.

In light of Mr. Schneiderman's recent resignation, the future of the NYAG's Active Share campaign is uncertain. However, there regrettably has been no indication that his replacement will take a more cautious, thoughtful approach into inserting the NYAG into the regulation of actively managed mutual funds.

M&A Transactions

Acquiror(s)	Acquired or Target Company	Type of Transaction and Status
BlackRock, Inc., a global investment manager with approximately $6.28 trillion in AUM	**Tennenbaum Capital Partners, LLC**, a private credit manager with approximately $9 billion of committed client capital	Acquisition (terms not disclosed)
Blackstone Strategic Capital Holdings, a Blackstone permanent capital vehicle which specializes in acquiring long term interests in leading alternative asset managers	**Rockpoint Group, L.L.C.**, a real estate private equity firm and registered investment adviser	Acquisition of a passive, minority equity stake (terms not disclosed)
Franklin Templeton, a California-based global investment management organization with approximately $753 billion AUM	**Edinburgh Partners Limited**, an independent fund management company that specializes in global and emerging markets equities with approximately $10 billion AUM	Acquisition (terms not disclosed)
Lovell Minnick Partners LLC, a private equity firm with expertise in investing in the financial and related business services sectors with approximately $1.7 billion in committed capital	**CenterSquare Investment Management**, a global investment manager focused on actively managed real estate and infrastructure strategies with approximately $8.9 billion AUM of real estate and infrastructure securities	Acquisition (terms not disclosed)
Macquarie Infrastructure and Real Assets, a division of Macquarie Asset Management of Macquarie Group with approximately €94 billion AUM	**GLL Real Estate Partners**, a real estate investment management group that focuses on commercial property portfolios in the international real estate sector with approximately $8.66 billion in AUM	Acquisition (terms not disclosed)
Mercer, a wholly-owned subsidiary of Marsh & McLennan Companies, Inc.	**BFC Asset Management Co., Ltd.**, a Japanese independently owned multi-manager	Acquisition (terms not disclosed)
Oaktree Capital Management, L.P., an investment manager specializing in alternative investments with approximately $100 billion AUM and **White Mountains Insurance Group, Ltd.**, a Bermuda-domiciled financial services holding company with approximately $6.5 billion AUM	**Kudu Investment Management, LLC**, a capital provider to asset management and wealth management firms	Acquisition of minority stake for $250 million
Scotiabank, a Canadian international bank	**Jarislowsky, Fraser Limited**, an independent investment management firm with approximately $40 billion AUM	Acquisition with a purchase price payable at closing of approximately $950 million will be satisfied primarily by the issuance of Scotiabank common shares
StepStone Group Real Estate LP, a real estate investment firm that is part of StepStone Group LP, a private firm that oversees approximately $130 billion in private capital allocations with approximately $34 billion AUM	**Courtland Partners, Ltd.**, an institutional investment adviser that provides advisory services in the real estate, infrastructure, energy, timber and agriculture sectors with approximately $95 billion AUM	Acquisition (terms not disclosed)

M&A Transactions *(continued)*

Acquiror	Acquired or Target Company	Type of Transaction and Status
Virtus Investment Partners, Inc. a distinctive partnership of boutique investment managers	**Sustainable Growth Advisers**, a growth equity manager focused on providing high conviction U.S., global and international portfolios primarily for institutional clients with approximately $11.6 billion AUM	Acquisition of a majority interest (terms not disclosed)
W.E. Donoghue & Co., LLC, a boutique investment firm with approximately $2.6 billion AUM	**JAForlines Global**, a New York-based investment management company with approximately $700 million AUM	Acquisition (terms not disclosed)
White Oak Equity Partners, a private equity firm that purchases non-controlling GP interests in alternative asset managers	**FCO Advisors LP**, a private municipal credit focused investment fund	Acquisition of a minority interest (terms not disclosed)

1st Quarter 2018 Closed-End Fund Public Offerings

Tortoise Tax-Advantaged Social Infrastructure Fund

Structure:	Interval fund with quarterly repurchase offers of 5% of its outstanding common stock
Investment Objectives/ Policies:	The Fund's investment objective is to seek to generate attractive total return with an emphasis on tax-advantaged income. "Tax-advantaged" income is income that by statute or structuring of a security is in part, or in whole, tax-reduced, tax-deferred or tax-free with respect to federal, state or municipal taxes. The Fund seeks to achieve its investment objective by investing at least 80% of its total assets in the social infrastructure sector. The "social infrastructure sector" includes assets and services that accommodate essential services related to education, healthcare, housing, human service providers and social services. Such assets and services may include, but not be limited to, primary, secondary and post-secondary education facilities; hospitals and other healthcare facilities; seniors, student, affordable, military and other housing facilities; industrial/ infrastructure and utility projects; and nonprofit and civic facilities. The Fund is not required to invest in all such types of social infrastructure securities at all times. Issuers of social infrastructure securities and obligations may include governmental entities or other qualifying issuers of states, municipalities, territories and possessions of the United States and the District of Columbia and their political subdivisions, agencies and instrumentalities, private non-profits, 501(c)(3)s, public nonprofits and other entities authorized to issue private activity and tax-exempt municipal bonds.
Manager:	Tortoise Credit Strategies, LLC
Distributor:	Quasar Distributors, LLC

Simpson Thacher's dynamic, long-standing Registered Funds Practice encompasses all aspects of the investment management business. Our practice focuses on alternative asset managers seeking to access retail investor channels, asset management mergers and acquisitions, and advising on cutting-edge regulatory policy and strategy matters.

David W. Blass • 1-202-636-5863 • david.blass@stblaw.com

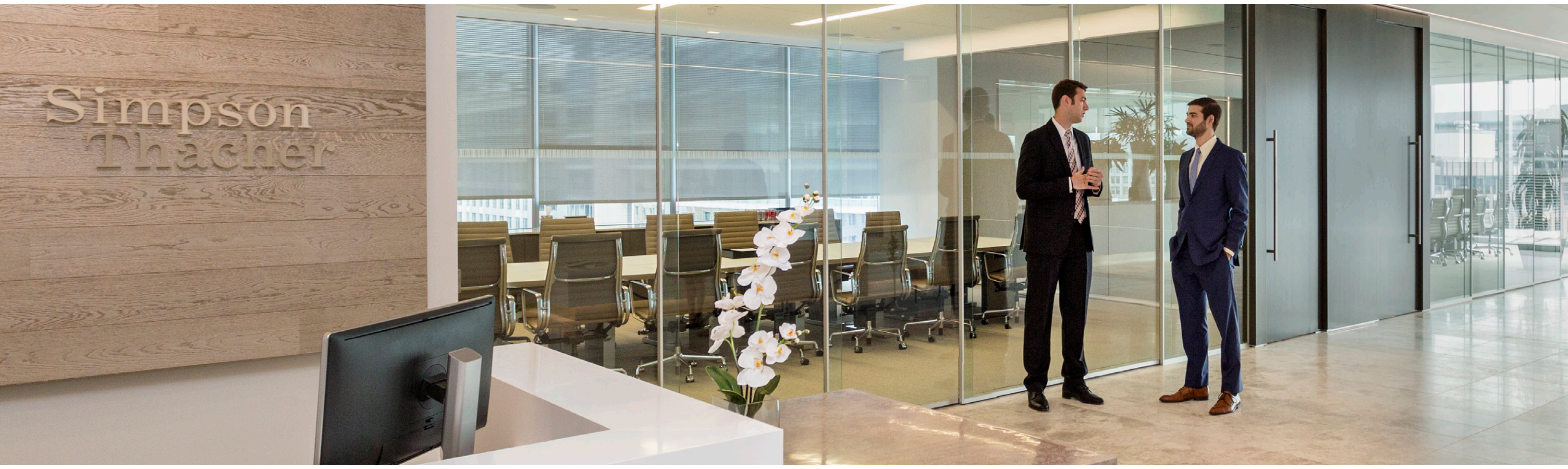
David Blass is a Partner in Simpson Thacher & Bartlett LLP's Investment Funds Practice. David is a leading regulatory lawyer in the funds industry and has advised on matters involving innovative registered funds products, Investment Advisers Act compliance, SEC examination and enforcement matters, and broker-dealer regulatory compliance. Prior to joining Simpson Thacher, David served as General Counsel of the Investment Company Institute (ICI), where he was responsible for the full range of legal and regulatory matters affecting the asset management industry, including investment company, capital markets, pension and tax issues. He also previously was Chief Counsel of the SEC's Division of Trading and Markets.

Rajib Chanda • +1-202-636-5543 • rajib.chanda@stblaw.com

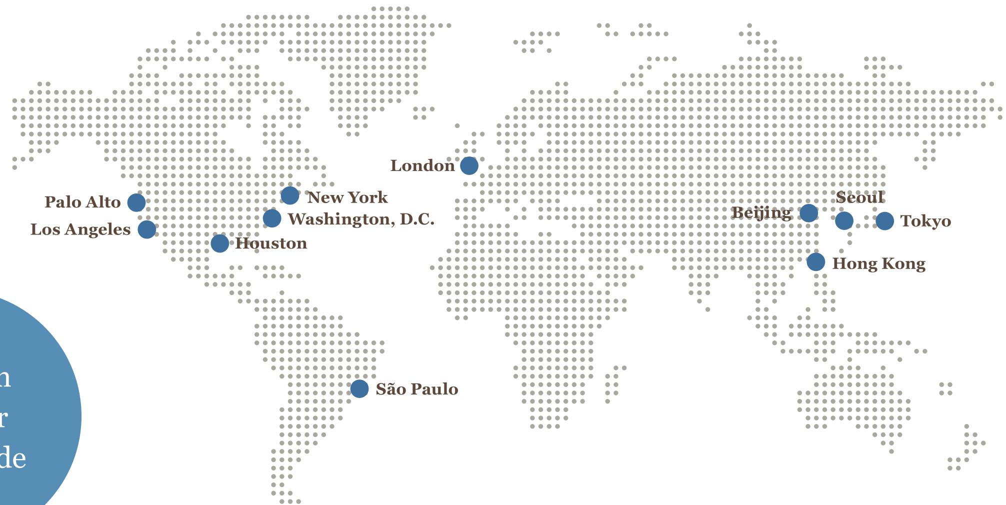
Rajib Chanda is a Partner in the Washington, D.C. and New York offices of Simpson Thacher & Bartlett LLP, and is the Head of the Firm's Registered Funds Practice. Rajib's practice focuses on all aspects of issues facing registered investment advisers and sponsors of registered funds. Rajib has particular experience working with alternative asset managers seeking to access retail investor channels through mutual funds, business development companies, closed-end funds, exchange-traded funds and permanent capital vehicles. He also works extensively with more traditional registered fund sponsors and works closely with the firm's asset management M&A group on transactions involving registered advisers and funds. In addition, Rajib provides counsel to boards of registered funds, and has substantial experience advising companies on issues relating to social media and cybersecurity.

Sarah E. Cogan • +1-212-455-3575 • scogan@stblaw.com

Sarah Cogan is a Partner in the New York office of Simpson Thacher & Bartlett LLP. Sarah's practice encompasses all aspects of the registered funds industry and she represents closed-end investment companies, open-end mutual funds, investment advisers and independent directors of investment companies. She has a particular expertise in advising underwriters and sponsors in offerings by closed-end funds and business development companies. In addition, Sarah advises fund clients on corporate and securities law, including investment management, regulatory, compliance and M&A matters.



Simpson
Thacher



Simpson
Thacher
Worldwide

UNITED STATES

New York
425 Lexington Avenue
New York, NY 10017
+1-212-455-2000

Houston
600 Travis Street, Suite 5400
Houston, TX 77002
+1-713-821-5650

Los Angeles
1999 Avenue of the Stars
Los Angeles, CA 90067
+1-310-407-7500

Palo Alto
2475 Hanover Street
Palo Alto, CA 94304
+1-650-251-5000

Washington, D.C.
900 G Street, NW
Washington, D.C. 20001
+1-202-636-5500

EUROPE

London
CityPoint
One Ropemaker Street
London EC2Y 9HU
England
+44-(0)20-7275-6500

ASIA

Beijing
3901 China World Tower
1 Jian Guo Men Wai Avenue
Beijing 100004
China
+86-10-5965-2999

Hong Kong
ICBC Tower
3 Garden Road, Central
Hong Kong
+852-2514-7600

Seoul
25th Floor, West Tower
Mirae Asset Center 1
26 Eulji-ro 5-gil, Jung-gu
Seoul 100-210
Korea
+82-2-6030-3800

Tokyo
Ark Hills Sengokuyama Mori Tower
9-10, Roppongi 1-Chome
Minato-Ku, Tokyo 106-0032
Japan
+81-3-5562-6200

SOUTH AMERICA

São Paulo
Av. Presidente Juscelino
Kubitschek, 1455
São Paulo, SP 04543-011
Brazil
+55-11-3546-1000