MFDF

Trusted Insight for Independent Oversight

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MFDF Report

Practical Guidance for Fund Directors on Oversight of Alternative Investments

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EXECUTIVE SUMMARY

With retail investors seeking exposure to fast-growing private markets and other alternative investment strategies, investment advisers ("Advisers")[1] and fund[2] sponsors are finding increasingly creative and unique product offerings outside traditional investment strategies. For fund boards of directors ("Boards"), this shift means understanding new and different asset classes, as well as novel product structures and corresponding board oversight responsibilities.

This paper (the "Paper") outlines certain types of product structures, the responsibilities associated with overseeing these products, including potential challenges, and questions that fund independent directors and trustees ("Directors") may consider when overseeing an alternative product.[3]

The responsibilities of a Board, as prescribed by the Investment Company Act of 1940, as amended ("1940 Act"), do not fundamentally change between a more traditional investment strategy and an alternative strategy. Some of these investments may present unique challenges, and boards may find special education on these investments helpful to navigate this emerging space.

Effective oversight of alternative vehicles requires an understanding of several key areas, including available registered investment company ("RIC") structures, Board oversight responsibilities, and resources available to Directors. As such, the Paper will be divided into the following sections:

- Vehicles for Retail Investor Access to Alternative Investments
- Fund Director Oversight Responsibilities
- Resources for Fund Directors

We encourage Directors to use this practical guide as a starting point to develop a deeper understanding of the alternative funds space. MFDF encourages Boards to consult with legal counsel before making any requests or changes to their policies and procedures.

MFDF would like to thank Simpson Thacher & Bartlett for sharing their expertise and contributing to this White Paper.

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Introduction

Historically, traditional registered investment products offered exposure to stocks and bonds with a focus on more conventional strategies such as growth, value, and sector investing. As investor demand for higher returns and greater diversification has increased, so has the demand for access to private markets. In turn, the presence of alternative investments offered within retail funds has also grown. The 2024 EY Global Alternative Fund Survey stated that "global AUM for alternative assets is projected to reach US$29.2t by 2029, fueled by the accelerated democratization of private markets, enhanced access for individual investors and growing demand for portfolio diversification from institutional investors."[4] As investor demand has grown, so have the investment types and strategies of 1940 Act funds.

This growth in demand for alternative investments presents Boards with asset types and product structures which may pose unique questions. While the oversight responsibilities of Directors remain similar to those overseeing more traditional product offerings, there are key considerations to keep in mind during the oversight process of alternative products, particularly with regard to valuation, liquidity risk, leverage, and other important areas. It is imperative that Directors consider the relevant challenges and ask informed questions of the Adviser and counsel as these products are launched and offered to investors.

It is the goal of this Paper to bring those important Board considerations forward and provide suggested questions for Boards to consider as they oversee these novel products.

Vehicles for Retail Access to Alternative Investments

This section includes a brief overview of each product type and unique Board considerations that may be involved in the oversight process. While the duties of oversight do not change from product to product, there are some nuances that should be recognized, which will also be discussed further in the following sections of the Paper.

Directors may wish to engage with management on how the alternative investments are being marketed to investors, whether sales teams are properly educated on new asset classes, how the specific product structure was selected, any other product structures that management considered, and whether new distribution channels will be pursued to sell these products.

OPEN-END FUNDS

Open-end funds include traditional mutual funds and ETFs, both fund structures are offered either through a retirement account, a financial adviser, directly from the fund, or through the public markets. Advisers may prefer to offer open-end funds because they provide the opportunity to gain access to a wide variety of investors. Due to the need to provide for redemptions, open-end funds have increased liquidity requirements. Open-end funds must assess and manage their liquidity risk by classifying investments into four categories, setting a minimum level of highly liquid assets, and limiting illiquid holdings to 15%. Open-end funds must have at least $3.00 of total assets for every $1.00 of debt that they have, as the 1940 Act imposes a 300% asset coverage requirement. Open-end funds are also permitted to use derivatives, but Rule 18f-4 under the 1940 Act established new limits for these activities. Directors may want to inquire whether the Adviser is following liquidity constraints and monitoring market changes that may impact valuation, leverage, diversification, or concentration risk.

CLOSED-END FUNDS

Closed-end funds have more flexibility to offer alternative investment exposure due to the regulatory structure surrounding these products. Increasingly, Advisers use tender offer and interval funds to allow such funds to increase their leverage and offer investors exposure to a variety of alternative strategies that may be less liquid. Closed-end funds must have at least $3.00 of total assets for every $1.00 of debt that they have, as the 1940 Act imposes a 300% asset coverage requirement. In addition, closed-end funds can also issue preferred shares and must have at least $2.00 in total assets for every $1.00 in preferred shares and debt, as the 1940 Act imposes a 200% asset coverage requirement in this case. Closed-end funds may use derivatives and other instruments, subject to Rule 18f-4, which imposes certain limitations and requirements. Closed-end funds and Business Development Companies ("BDCs") are not subject to portfolio liquidity requirements because they are not required to provide daily liquidity to shareholders. One limited exception is an interval fund that must hold liquid assets from the time that notice of a repurchase offer is sent to investors until the repurchase pricing date.

Historically, the Securities and Exchange Commission ("SEC") staff has taken an informal position that closed-end funds can invest no more than 15% of their net assets in private funds, unless the fund limits sales to accredited investors and imposes a minimum initial investment of $25,000.[5] However, in May 2025, the SEC staff announced they will no longer require closed-end funds to limit their investments in private funds to 15% of their net assets.[6] In a statement, SEC Chair Paul Atkins highlighted key issues for these products, including conflicts of interest, illiquidity and fees.[7]

Listed Closed-End Funds

Listed closed-end funds offer a fixed number of shares that are listed and traded on an exchange. Because the fund is traded on an exchange, the Adviser may gain access to retail investors more easily than with other closed-end fund structures. One key difference between listed closed-ends and open-end funds is that listed closed-end funds may trade at a premium or discount. Because the fund has a fixed number of shares and calculates its net asset value ("NAV") based on portfolio holdings, the fund's market trading value could be lower than the fund's NAV, which means the fund would be trading at a discount. Historically, some listed closed-end funds have been involved in cases of activism, where a shareholder builds a position in the fund and then attempts to use that position to exert control over the management, strategy, or board of the fund.

Questions Directors may wish to consider include, but are not limited to:

- **Does the fund trade at a discount or premium, and if so, what is the percentage? What are the implications that trading at a particular discount may have on the fund, particularly if an activist investor has accumulated shares in the fund?**
- **Does the sponsor have proactive plans to help the fund to trade more efficiently? If so, how and when would they be deployed?**
- **Do recent regulatory changes lifting the requirement that closed-end funds limit their investments in private funds to 15% of their net assets impact the fund(s) they oversee?**

Interval Funds

Interval funds are closed-end funds that are frequently offered on a continuous basis while allowing for periodic liquidity through share repurchases at set intervals. Intervals are established at the inception of the fund and can vary between 3-, 6-, and 12-month intervals. Intervals are set by the fund's board after taking into consideration the recommendation of the fund sponsor.[8] These intervals can only be changed by a majority vote of the outstanding voting securities of the fund.[9] The interval fund rule requires the fund to calculate weekly NAVs, and at certain times daily NAVs. As a practical matter, however, financial intermediaries will require an interval fund to calculate daily NAVs in order to be included on interval fund platforms. Aside from liquidity requirements surrounding share repurchase periods, there is otherwise no regulatory limit on illiquid investments for interval funds.

Before each repurchase offer, the Board will determine the repurchase offer amount (between 5% and 25% of outstanding shares). The fund will then set a deadline for repurchase requests. Shares will be offered at NAV and may only include a nominal repurchase fee of up to 2%. From the time an interval fund sends a notification to shareholders about the repurchase offer until the date on which the interval fund determines the net asset value applicable to the repurchase offer, a percentage of the interval fund's assets equal to at least 100% of the repurchase offer amount must consist of liquid assets, i.e., assets that can be sold or disposed of in the ordinary course of business, at approximately the price at which interval fund has valued the investment, within a period equal to the period between the close of the repurchase offer and the payment date for the repurchase offer, or of assets that mature by the next payment date for the repurchase offer.

Questions Directors may wish to consider include, but are not limited to:

- What percentage of investors are submitting shares for repurchase?
- If the share repurchases continue to be oversubscribed for an extended period, does the investment strategy continue to be viable as an interval fund and, if not, what are the appropriate considerations around the potential for converting the fund to a different structure or winding down the fund?
- What is the process used to determine the appropriate percentage for the share repurchase offer amount?
- Are the repurchase offer terms and amount consistent with the fund's fundamental policy and SEC rules?
- How is the Adviser managing liquidity during the period required by SEC rule?

Tender Offer Funds

Tender offer funds, similar to interval funds, are closed-end investment vehicles frequently offered on a continuous basis and provide periodic liquidity to shareholders through tender offers. While interval funds conduct repurchase offers at set intervals, tender offer funds are not required to conduct a minimum frequency or number of repurchase options. Similar to interval funds, tender offer funds offer shares at a price based on the fund's NAV. There is no limit on illiquid investments for tender offer funds, although they must maintain enough liquidity to fund the repurchase requests received pursuant to any tender offer.

Tender offer funds offer periodic tenders typically at the discretion of the Board. In practice, most tender offer funds conduct tender offers on a regular cadence, typically quarterly, and for the same amount (such as 5% of outstanding shares) each time. When conducting a tender offer, the fund must follow the requirements of Rule 13e-4 under the Securities Exchange Act of 1934[10] (the "Exchange Act"), which governs the terms with which a fund must comply when making a tender offer. Requirements include filing Schedule TO with the SEC, providing comprehensive disclosures to investors, and adhering to strict timelines for each tender offer.

Questions Directors may wish to consider include, but are not limited to:

- How many investors are submitting shares in the tender offers?
- If the tender offers continue to be oversubscribed for an extended period, does the investment strategy continue to be viable as an interval fund and, if not, what are the appropriate considerations around the potential for converting the fund to a different structure or winding down the fund?
- What is the process used to determine the appropriate percentage for the tender offer amount?
- Is the tender offer conducted in compliance with regulatory requirements?
- How is the Adviser managing fund liquidity in order to pay the proceeds of each tender offer?

Business Development Companies

BDCs are closed-end investment vehicles that operate to make investments in smaller, developing businesses. These smaller and/or developing businesses may have difficulty obtaining financing from more traditional sources, like banks, or may seek bespoke financing structures that can be more readily offered by BDCs and other non-bank lenders.

There are three main types of BDCs: (1) publicly traded BDCs, (2) publicly offered, non-listed BDCs (non-traded BDCs), and (3) privately offered BDCs.[11] For the purposes of this Paper, we will assume the BDC must comply with applicable laws under the 1940 Act. As a technical matter, a BDC does not register under the 1940 Act, but instead elects to be subject to regulation by the SEC under many of the provisions of the 1940 Act, including requirements for independent board members, valuation, and restrictions on investments in other RICs. BDCs can employ more leverage than registered closed-end funds, which can make BDCs an attractive structure for debt investments. BDCs must have $2.00 of total assets for every $1.00 of debt, however, the Consolidated Appropriations Act of 2018 amended BDC asset coverage requirements in the 1940 Act to impose a 150% asset coverage requirement (so only $1.50 of total assets would be required for $1.00 of debt) subject to certain conditions being met.[12]

Because some BDCs are subject to regulation under the 1940 Act, there are requirements for diversification, transactions with affiliates, and constraints on debt-to-equity holdings. In addition, BDCs are required to invest at least 70% of their total assets in "qualifying assets," which generally includes eligible portfolio companies, cash, and government securities. BDCs may use the remaining 30% to invest in non-U.S. companies or other "non-qualifying assets."[13]

One major difference between BDCs and other closed-end fund structures is the requirement that BDCs "make available significant managerial assistance" to the companies they invest in.[14] BDCs typically build a portfolio of holdings by lending to portfolio companies, primarily in the form of floating-rate loans.[15] More recently, however, BDCs have also made "non-sponsor-backed" loans to companies that are not owned by private equity funds, similar to commercial banks.

Questions Directors may wish to consider include, but are not limited to:

- **Does the Board have an understanding of corporate reporting and corporate strategy due to the managerial assistance requirement?**
- **If the Adviser is coming from the private fund space, does the Adviser understand the requirements of the 1940 Act that apply to BDCs?**

Director Oversight of Alternative Investments

While certain aspects of alternative investment oversight may be unique, the fundamental responsibility of Directors to act in the best interests of the fund and its shareholders does not change. Boards that oversee these products may see changes in emphasis and length of discussion in areas including valuation, peer groups, leverage, and liquidity, among others. It remains important for Boards to develop and regularly examine policies and procedures; ensure the fund has the proper resources to employ an experienced compliance team, auditor, and legal counsel; and to understand the long-term performance and viability of the fund. Boards may want to periodically request educational sessions from management and/or legal counsel when overseeing new fund structures or asset classes.

VALUATION

Proper valuation of a fund's portfolio securities is critical to the calculation of a fund's NAV, asset coverage requirements, management fee calculations, and other purposes. While Directors do not play a day-to-day role in the pricing of a fund's individual investments, Directors bear the ultimate responsibility for valuing those securities without a readily available market quotation.[16] With this in mind, the process for valuing alternative investments has the potential to be more complex and/or require the involvement of a pricing services vendor.

Rule 2a-5 under the 1940 Act provides requirements for determining fair value in good faith, addresses valuation practices, and outlines the role of a fund's Board with respect to the fair valuation process. Rule 2a-5 permits Boards to designate the day-to-day responsibility for determining the fair value of all or some securities to a "valuation designee," who generally must be the Adviser.[17] Rule 2a-5 generally requires the Board, or the valuation designee,[18] to:

- Assess and manage valuation risks
- Establish and apply fair value methodologies
- Test the appropriateness and accuracy of the methodologies selected
- Oversee third-party pricing services, if used

The responsibilities under Rule 2a-5 do not change when overseeing alternative investment products and assets. It is important that the Board examine and understand the type of assets held and whether the Adviser's valuation team has the expertise necessary to properly value each security. In addition, the Board should work with the Chief Compliance Officer ("CCO") to determine whether policies and procedures are followed.

Rule 2a-5 requires the valuation designee to provide three different types of reports to the Board: annual, quarterly, and prompt reports. Boards will want to work with their Adviser to determine what should be included in each report, keeping in mind the requirements of Rule 2a-5. Boards may also decide to request a dashboard as part of their reporting to streamline and flag specific areas of concern. Examples of what may be included in reports include:

- Movements of securities from Level 2 to Level 3
- Any differences in the pricing of Level 2 or Level 3 securities held by the Adviser in other side-by-side vehicles
- Securities that trade outside of a set variance and whether the variance is acceptable
- Valuation trigger points that would require an update to the Board if the threshold is breached
- Use of prompt reports to stay well-informed of developing situations and market events that may impact valuations
- Valuation challenges from the portfolio management team

The SEC has stated that "boards are not providing appropriate oversight if they simply rely on information presented to them without actively probing it, asking questions, and seeking relevant information, particularly when there are red flags or other indications of problems."[19] Additionally, Directors should also request follow-up information when appropriate and take reasonable steps to see that matters identified are addressed.[20]

Questions Directors may wish to consider include, but are not limited to:

- Who sits on the Adviser's valuation committee, and what is their level of expertise? How is the Board apprised of the actions of the Adviser's valuation committee and what level of detail is appropriate?
- What are the fund's valuation policies and procedures? What is the process required by the procedures? How and under what circumstances can the procedures be amended?
- What are the valuation methodologies used?
- Are there any potential conflicts of interest or bias in the valuation process?
- How do valuation timing requirements differ between open-end and closed-end funds?
- Are the valuation procedures for illiquid assets appropriate?
- Is there a process in place for identifying and managing stale valuation marks and lagged private equity valuations?
- What is the role that third-party pricing vendors play in the valuation process, and how are challenges to those valuations handled?
- Does the Board have a process to oversee third-party pricing vendors? This may include asking vendors to discuss with the Board/audit committee their processes and guardrails.
- How does the Board independently verify the reasonableness of valuations—particularly when the adviser relies heavily on third-party marks or model-based assumptions?
- What back-testing models exist? How can the board evaluate whether and when changes need to be made to those procedures?
- Has the Board conducted regular consultations with the auditors regarding the process for valuing illiquid securities?

LIQUIDITY

By nature, many alternative assets are less liquid if they are not actively traded on the open market and lack the demand that can allow a fund to exit a position quickly and without much movement in the value of the asset. Boards need to be keenly aware of liquidity constraints and issues that may impact the product structure they oversee.

The adoption of 1940 Act Rule 22e-4 requires open-end funds (mutual funds and ETFs) to adopt liquidity risk management programs. A fund's liquidity risk management program must include written policies and procedures to classify the liquidity of each of a fund's investments, periodically review the fund's liquidity risk, determine the fund's "highly liquid investment minimum," and adopt policies and procedures for in-kind redemptions. In its oversight role, the Board must initially approve the liquidity risk management program, approve an administrator for the liquidity program, and review (at least on an annual basis) a written report compiled by the liquidity program's administrator highlighting the implementation, continued effectiveness, and whether any material changes were made.[21]

In the Rule 22e-4 adopting release, the Commission noted that, "[a] few of the funds observed by staff conduct stress testing relating to the availability of liquid assets to cover possible levels of redemptions."[22] It added that funds have employed "a diversity of practices" to manage liquidity risk, including, "conducting stress testing relating to the extent the fund has liquid investments to cover possible levels of redemptions."[23] The Commission ultimately did not adopt a requirement for stress-testing, but chose to rely on the "highly liquid investment minimum" requirement.[24] Some Advisers still undertake liquidity stress-testing even though it is not required as an added part of their liquidity risk management program.

Questions Directors may wish to consider include, but are not limited to:

- Does the Adviser utilize a dashboard to show the bucketing of securities, particularly in times of market stress?
- What type(s) of liquidity risk is the Adviser monitoring? This may include reports that show liquidity trends and changes in the case of a market-moving event.
- Has the Adviser updated the respective risk disclosures in the fund documents to reflect any enhanced liquidity risk?
- Does the fund employ a credit facility to mitigate liquidity issues? If so, do all the funds participate in the credit facility? What is the amount of the facility and how is it monitored? Which funds have used the facility in the past, and under what circumstances?
- Are there insurance policy considerations that differ for funds that hold private assets from those that hold more traditional assets?
- Does the Adviser conduct stress-testing for liquidity risk management even if not required to do so?
- What quantitative liquidity stress tests does the adviser run, and how do results compare with peer funds and historical periods of volatility? Do they include historic and forward-looking scenarios?
- How does the Adviser manage liquidity to meet tender offer or repurchase requests?

LEVERAGE

Fund leverage involves using borrowed money as part of a fund's investment strategy. Leverage can include loans from a bank or, for closed-end funds and BDCs, loans from banks or other financial institutions or issuance of preferred shares. Funds can also use financial derivatives such as swaps, futures, and other structured notes to create leverage within a fund. While the 1940 Act limits how much leverage a fund can employ, both open-end and closed-end funds can use leverage to some extent.[25]

While leverage may lead to higher returns, it also involves potential risks. For instance, the cost of leverage may increase if interest rates spike, which could cause the costs of employing leverage to exceed the benefit derived, although that cost could be mitigated if the fund's investments also have floating interest rates. Additionally, funds that use leverage can experience greater volatility of net assets, as leveraged positions can change value quickly, impacting a fund's NAV calculation.[26] As a result, the ongoing use of leverage is common for funds that focus on debt investments, where the leverage can increase the fund's yield per common share. It is important to note, however, that all types of funds (debt and equity) may employ leverage to manage redemptions from time to time.

Questions Directors may wish to consider include, but are not limited to:

- What are the costs of leverage and its impact on fund returns?
- What reports does the Board receive from the Adviser regarding leverage?
- Is the Adviser benefitting from the use of leverage at the expense of the fund?
- What is the Adviser's approach to liquidity risk management to determine whether the fund can maintain appropriate sources of credit in times of stress or high redemptions (for example, a large fund that only relies on a credit facility with a bank for its leverage could experience increased risk of a liquidity crunch if the bank refuses to renew the credit facility)?
- How does the Adviser monitor the limitations within the loan agreement that may restrict portfolio holdings, as a counterparty is permitted to include various restrictions/covenants in a contract?
- For closed-end funds and BDCs does the failure to meet asset coverage requirements constitute a default under the lending agreement? Please note that failure to maintain the asset coverage requirements is not a violation of the relevant statute, but rather have certain consequences for the closed-end fund or BDC.

USE OF DERIVATIVES

As noted in the prior section, registered funds and BDCs may employ derivatives as a mechanism to enhance returns or hedge risk. Beginning in 2020, the SEC mandated an updated framework for derivatives risk management.[27] The updated framework requires a Board to approve the Derivatives Risk Manager who is responsible for overseeing the Derivatives Risk Management Program. The Adviser establishes the Derivatives Risk Management Program which must include policies and procedures reasonably designed to manage the fund's derivatives risk. The Board should understand the risk management program and inquire through thoughtful questions and reporting requests further information on the implementation and ongoing effectiveness of the derivatives risk management program.

A Board must receive a written report, at least annually, from the Derivatives Risk Manager that includes:

- Risk identification and assessment
- Risk guidelines
- Stress testing
- Back testing
- Internal reporting
- Escalation of material risks
- Periodic review of the risk program itself

The report must also include any changes to the risk management program approved by the Derivatives Risk Manager. The Board may receive periodic reporting, including on whether the fund exceeded the derivatives risk management program's established threshold guidelines on the fund's derivatives risks.[28]

Questions Directors may wish to consider include, but are not limited to:

- **Does the Board understand the Derivatives Risk Management Program and if the fund's CCO has regular access to the Derivatives Risk Manager or someone on the committee?**
- **Does the Board engage in quarterly conversations with the Derivatives Risk Manager to understand the process and what is driving changes in the risk management program?**
- **How does the Adviser conduct any stress tests? What conflicts could arise, and what is the process for resolving them? What controls are in place?**
- **Has the Board considered requesting quarterly reporting on risk trends?**

DIVERSIFICATION

Federal laws regulate the diversification of RICs (both open-end and closed-end funds) through requirements under the 1940 Act.[29] A diversified investment company is one in which 75 percent of the fund's total assets consist of cash (and cash items), government securities, securities of other investment companies, and other securities.[30] Securities of a single issuer that represent more than five percent of the fund's total assets or that represent more than 10 percent of the issuer's voting securities are not included in the 75 percent calculation.[31]

While the test appears to be straightforward, defining "issuer" may be difficult with respect to certain derivatives purchased by funds, especially certain alternative funds. Current law leaves questions in this area, including whether a particular derivative should be considered a security for purposes of the diversification test and, if so, whether a fund should look to the counterparty to the derivative transaction or the reference asset underlying the derivative to determine diversification.[32] Because shareholder approval is required when a fund changes status from diversified to non-diversified[33] (though such approval is not required to go from non-diversified to diversified), the Board will want to have confidence that there are processes and procedures in place to monitor a fund's compliance with the diversification requirement.

Additionally, if the Fund invests in private funds that are structured as limited partnership interests, the Fund must look through to the underlying partnership to properly perform the asset diversification test. Funds may be able to negotiate a side letter with the private fund to obtain information rights that would allow the Fund to receive portfolio level information more frequently than its financial reporting. Fund management should work with their investment team to seek to obtain this side letter term.

CO-INVESTMENTS

Co-investments allow funds to invest alongside the Adviser's or an affiliate's private funds. These investments are privately negotiated with the registered fund or BDC and the private fund operating from the same negotiating position. In 2025, the SEC began granting an updated form of co-investment exemptive relief that simplifies the co-investment process for closed-end funds and BDCs;[34] however, even the streamlined process requires oversight and action from a Board. For Directors that oversee co-investments, note that the role of the Director is one of oversight. A Director's role is not to evaluate the quality of the Adviser's investment decisions, but rather to ensure fairness for the fund and its shareholders in certain co-investment transactions where there is risk that conflicts of interest could arise.

Questions Directors may wish to consider include, but are not limited to:

- Does the Board understand the scope and parameters of the exemptive order?
- Does the proposed co-investment track the fund's overall investment mandate?
- How will the co-investment impact a fund's valuation and liquidity?
- Has the Board received sufficient documentation that the Adviser has performed all the necessary responsibilities to conform with exemptive relief in advance of individual co-investments?
- Is the Board receiving comprehensive reporting as a follow-up to co-investment transactions, in line with the requirements of the exemptive relief?
- Does the Adviser understand tax implications for asset diversification and gross income prior to making a co-investment in private assets? It may be necessary to do a tax analysis prior to investing in private assets to avoid any asset diversification or gross income failures.

OPERATIONAL AND PORTFOLIO MANAGEMENT CONSIDERATIONS

Directors should ask questions and gain comfort that the Adviser, sub-adviser (if any), and third-party service providers have the expertise to manage, support and market alternative investment classes as part of a 1940 Act product. Whether a traditional RIC Adviser looking to offer alternative products, or an alternative asset manager looking to enter the registered fund space, Directors should be prepared to ask questions. Small Advisers/fund complexes may be especially vulnerable to the costs associated with often complex operational and portfolio management requirements.

Portfolio Management: The Board, as part of its oversight function, should confirm that the Adviser has the experience and resources necessary to launch and manage an alternative fund. This includes whether the portfolio management team (as currently assembled) has the expertise in the investments contained in the proposed strategy. The portfolio managers and research analysts should have a thorough understanding not just of the investments, but how the investments may react to different market forces. Alternative investments can also include privately negotiated deals; thus, the Board may want to inquire whether the portfolio management team has sufficient staff and expertise in place to analyze and execute private transactions. Before launching a new product, the Board may wish to inquire how the Adviser plans to scale and market the product. Directors may also want to consider if there are any conflicts of interest, particularly if the fund manager operates both private funds and registered funds.

Compliance: When offering products with alternative investments, especially those that are new to the complex, the Board may want to confirm the experience and capabilities of the compliance team to oversee the new products. The Board may want to review CCO resources capabilities to take on the additional compliance challenges and requirements. Compliance professionals should understand the products and assets, not just the 1940 Act regulatory requirements.

Back-Office: In addition to the investment knowledge required to run an alternative fund, the Adviser and administrator also need sufficient middle- and back-office resources to support a new product. The Adviser needs the capability to make, confirm, and record trades of investments that may be new to the fund complex. Further, new products may not fit into existing fund record-keeping systems and therefore require manual data entry, which can raise issues of data accuracy. While an Adviser to a RIC must monitor portfolio holdings to comply with statutory and regulatory requirements, new investment vehicles and strategies may introduce additional complexities to these calculations. Boards may also wish to inquire whether the Adviser has appropriate technology systems in place or the resources to upgrade, if needed.

Sub-advisers: In some cases, the Adviser may decide to bring on a sub-adviser to manage the new investments. Many sub-advisers have significant experience investing in alternative securities or pursuing investment strategies not typically available in traditional funds. However, particularly if the prior experience came about in the private fund context, these sub-advisers may have little familiarity with the legal requirements of RICs. Accordingly, the Board will want to ask about how much experience, if any, the sub-adviser has had with RICs, as well as the Adviser's due diligence process in selecting the sub-adviser. The Board will also want to be aware of the Adviser's capabilities to oversee the sub-adviser and monitor the sub-adviser's compliance. The inquiry is ongoing—Directors will want to have confidence in the resource and compliance environment surrounding any sub-adviser at the time of the initial engagement, and on an ongoing basis, particularly after any changes to structure or personnel at the sub-adviser.

As noted above, the 1940 Act and its regulations differ in some important ways from regulations governing private funds, including affiliated transaction limitations, restrictions on performance-based fees, calculation of a daily NAV, restrictions on illiquid securities, leverage limits, asset diversification, and concentration limits, among others. Exploring how much experience the proposed sub-adviser has with RICs can help the Board focus its approval inquiry and subsequent oversight efforts on areas of the most significant risk. Performance-based fees are common among private fund managers; the Board may want to inquire whether the sub-adviser understands the compensation practices and fee disclosure issues in RICs. It is also important for the sub-adviser to understand the role and oversight function of the Board, and the need for transparency and trust.

Other Service Providers: Valuation agents, fund administration, fund accountants, and other service providers need to have the appropriate expertise and resources necessary to adequately provide services to the alternative fund. In some cases, this will involve teams within existing service providers; in other cases, different service providers may need to be engaged. The Board may want to ask whether the Adviser has contemplated whether existing service providers have the expertise necessary, and if not, whether they have identified an alternative.

Questions Directors may wish to pose when overseeing a new product launch:

- Who is the end user for this product? What is the marketing and distribution plan to bring the product to investors?
- What is the plan to equip these teams with the requisite knowledge to distribute the new product?
- Is the Adviser prepared to expend the additional operational and other costs required to bring a new alternative product to market?
- What are the terms of the seed capital? What are plans for reinvestment in order to scale the product offering? How does the Adviser plan to scale the fund as assets under management grow?
- Does the Adviser have a team in place to review private credit/ private equity deals and the implications those transactions will have on the fund's liquidity and valuation?
- Do the Adviser and sub-adviser, if any, understand how the underlying assets comply with the requirements of the 1940 Act and the Internal Revenue Code?
- Do the relevant compliance teams of the Adviser, Sub-Advisers and the fund have the experience and resources necessary to execute their responsibilities?
- Does the Adviser or fund sponsor have adequate relationships with service providers that understand 1940 Act requirements? Do they have the resources to engage with new service providers if necessary?
- Does the Adviser or sub-adviser, particularly if coming from the private fund space, understand the responsibility of reporting to the Board?
- If a fund manager operates both private funds and registered funds, are there conflicts of interest that can be identified? Are there conflicts of interest, while not present at the time of investment, that may arise later?

Questions Directors may wish to pose in their ongoing oversight:

- If there is a sub-adviser, what due diligence has the Adviser done on the sub-adviser? What is the Adviser's understanding of the investments for which the sub-adviser will be responsible?
- How are duties and responsibilities allocated between the Adviser and the sub-adviser, if any?
- If there is a sub-adviser, does the Adviser understand its role in ensuring the sub-adviser properly assesses valuation, liquidity, leverage and other relevant issues in RICs?
- How does the Adviser evaluate the performance of the sub-adviser?
- How is the Adviser managing the allocations among multiple sub-advisers to a fund?
- How does the adviser ensure fair allocation of investment opportunities between this fund and related private vehicles?

FUND PERFORMANCE, BENCHMARK, AND PEER GROUP CHALLENGES

It is important to note that the 15(c) process does not drastically change for Directors of alternative products. It may, however, be more labor-intensive with alternative investments than if the fund were investing in more traditional assets. Directors may wish to determine, with the help of counsel, that information requests are appropriately tailored to these investments and that Adviser responses are sufficiently comprehensive. Additionally, education on the 15(c) process may be helpful for an Adviser and/or sub-adviser that has not previously managed a 1940 Act vehicle.[35]

The assessment of a fund's performance is a key responsibility of Directors. Alternative funds in particular may present a number of unique challenges as a result of their complex investment strategies. Additionally, there are many factors that can make analysis of performance difficult for alternative funds. Examples include:

- The fund's investment strategy may be complex and have multiple objectives
- A newly launched fund has a shorter performance track-record than comparable funds
- Funds that invest in the same general asset class may have very different strategies that result in different risk/return profiles

While third-party data providers would not typically include high-yield bond funds in the peer group for an investment grade bond fund because both funds invest in fixed income, similar inconsistencies in third-party data remain prevalent today in more nascent fund asset classes such as private credit.

Boards should understand how the Adviser or third-party service providers identify appropriate benchmarks and peer groups. Boards may want to consider requesting educational sessions on specific products or strategies used in their funds, as well as how to evaluate expected performance over a range of market conditions. The Board may also want to ask for a third-party report on appropriate benchmarks and peer groups.

The SEC requires open-end funds to show their performance against an "appropriate broad-based securities market index."[36] However, an alternative fund may not have an obvious index or other benchmark that corresponds to the strategy that the fund is pursuing, making selection of an appropriate benchmark more difficult than for a traditional fund. When a fund's anticipated performance cannot be accurately evaluated based on a single benchmark, some managers use custom benchmarks as a secondary index. Custom benchmarks may rely on several indices with different weights (e.g., the custom benchmark may consist of 40% of one broad-based index, and 60% of a second, different index). If using a custom benchmark, the Board should understand how it was constructed and how it mirrors the fund's strategy and assets. There is often no obvious "right" benchmark, particularly if the fund is pursuing a novel strategy, and the benchmark selected may not be entirely reflective of whether the fund is performing as anticipated.

As many alternative funds advance novel strategies, Advisers and Boards may find traditional peer group comparisons to be of limited value. Even funds that pursue similar strategies may rely on different investments, making peer group comparisons more challenging. It is important to note there may not be a perfect peer group for a given alternative strategy. Boards can work with management to understand peer comparisons in the context of a particular alternative fund, including whom the Adviser may view as a competitor to the fund.

The Board may engage with a third-party firm to better understand appropriate benchmarks and peer groups. Boards may want to consider whether a detailed report on how a decision was made on a benchmark or peer group would be helpful.

Questions Directors may wish to consider include, but are not limited to:

- How does the Adviser measure performance? Can the Adviser identify a fund(s) that it considers “in competition with” the fund being managed?
- What measures does the Adviser find most helpful to evaluate how well the fund is achieving its performance goals, and would these same metrics and reports be useful to the Board in its evaluation of the fund’s performance?
- Would receiving more frequent information (perhaps quarterly), particularly in the early lifecycle of the fund, be helpful to track performance and growth?
- What are the most appropriate alternative performance benchmarks for this strategy, and why?
- If a standard benchmark is not appropriate, how was a custom benchmark designed? How does it reflect the strategy and assets within the fund?
- If the fund only has a broad-based securities market index as a benchmark, is the Advisor comfortable that such a benchmark is an adequate measure of investment performance success or failure?
- What third-party resources are available to analyze potential benchmarks and peer groups?

DISCLOSURE

The SEC has indicated that funds must disclose principal investment strategies tailored specifically to how a fund expects to be managed. Because Directors sign the fund’s registration statements, the Board (working with counsel) and the Adviser should establish procedures to review disclosure on a complex-wide basis. The prospectus disclosure for an alternative fund may be more complex than for traditional, long-only equity or fixed income funds, as a result of the complex nature of the strategies that many alternative funds pursue. Portfolio managers who have an understanding of the securities, strategies, and risks of the fund can be an excellent resource when drafting fund disclosure. In addition, the Fund’s CCO should monitor and counsel may periodically review the fund’s schedule of investments, to ensure that the disclosure matches the fund’s portfolio on an ongoing basis. Fund counsel and the Adviser can be useful partners when reviewing a fund’s disclosure.

ADDITIONAL REGULATORY CONSIDERATIONS

Amendments to the Names Rule

The "Names Rule" (Rule 35d-1) under the 1940 Act was amended by the SEC in September 2023[37] and requires RICs with names suggesting a specific investment focus to adopt a policy to invest at least 80% of their assets in the investments or sectors indicated by their name. The amendments broaden the 80% investment policy requirement to cover fund names that imply an emphasis on strategies such as "growth" or "value," or a certain thematic investment focus, among other changes.

Boards may want to engage with the Adviser on how the Adviser is approaching the implementation of the Names Rule amendments with regard to the relevant fund(s). Specifically, the Adviser will need to conduct an inventory of fund names to determine the impact of the amended Names Rule on each fund. Additionally, funds covered by the Names Rule will need to determine reasonable definitions for terms included in the 80% investment policy. Due to the complexity of alternative investments, the Board may want to pay particular attention to these types of funds. Additionally, the Board may want to ask for an update on the progress of this process. If a fund's 80% investment policy needs to be changed, a shareholder vote may be required. The Board may want to work with counsel to ensure the Adviser is taking the necessary steps to ensure compliance within the proper timeframe.

Concentration

The 1940 Act requires that RICs disclose their policy with respect to concentration in a particular industry or group of industries.[38] Concentration for this purpose is an investment of more than 25 percent of a fund's assets in a particular industry.[39] Because changes in concentration policy generally require shareholder approval, there should be processes and procedures for monitoring a fund's investments to determine when a security acquisition threatens to approach the 25 percent level for a non-concentrated fund. For concentrated funds, Boards will similarly want to understand that the Adviser has policies and procedures in place to monitor transactions that would potentially cause the fund to go below that level.

Fair Allocation of Trades

Securities laws require fair and equitable allocation of investment opportunities and trades among mutual funds and other accounts. Fair allocation can be of particular concern when the Adviser or sub-adviser manages other funds with a similar investment strategies—especially where the fees paid by the other funds may be higher than the fee paid by the mutual funds, or where there may be fees based on performance. Consequently, the Board may want to discuss with the Adviser what controls are in place to monitor fair allocation on an ongoing basis.

Tax Issues

Compliance with Subchapter M of the Internal Revenue Code allows funds to pass along the taxes on capital gains, dividends, or interest earned to investors and avoid having to pay taxes at the investment company level.[40] Subchapter M requires funds to comply with a qualified income test and a diversification test, both of which may be more challenging with alternative funds holding complex investments.[41] The qualifying income test requires that at least 90% of the fund's income come from passive investment sources such as capital gains, dividends, and interest. For example, commodity futures or private operating companies may not generate "qualifying income" for purposes of this requirement. A fund that would otherwise earn non-qualifying income from a particular investment may instead use a "blocker" subsidiary to make the investment, thus converting the income into qualifying income at the fund level.[42] A "blocker" is an entity (ex. a U.S. C-Corporation) that can allow an investment manager to use investment strategies that are typically incompatible with a registered fund, within certain parameters.

To ensure that funds adhere to the diversification requirements of the Internal Revenue Code, the funds must ensure that they have a sufficient tax analysis performed prior to making an investment and any blocker subsidiaries must be taken into account.[43] Boards will want to discuss these tax issues with fund counsel and fund auditors and may want to consider requesting additional educational sessions on these topics.

Resources

Boards have a variety of resources at their fingertips to better understand the portfolio and operational issues surrounding alternative investments. This section will highlight those resources and how best to utilize the expertise available.

CHIEF COMPLIANCE OFFICER (CCO)

The fund's CCO is critical in terms of information flow and reporting to the Board. Whether the CCO is in-house or outsourced, the Board may want to consider additional meetings with the CCO in executive session, beyond the annual meeting requirement in Rule 38a-1.[44] The CCO offers a unique window into the Adviser and the inner workings of the fund. The Board should ensure that the CCO and the compliance team have adequate resources and expertise (as noted above) in alternative investments. The Adviser's support of the CCO is also critical, whether the CCO is fund-only, also serves as the Adviser's CCO, is employed by the Adviser, or is outsourced. The CCO should feel confident that they have the autonomy and authority to ensure that the policies and procedures of the fund's compliance program are effectively implemented.

LEGAL COUNSEL

Directors may also rely on legal counsel for assistance in carrying out their oversight of alternative investments. Counsel may act as a useful third-party perspective and have experience dealing with different alternative investments and products. Fund and/or independent counsel also help the Board execute its oversight duties within legal requirements and can also update the Board on legal developments that may impact the alternative investments space. Additional areas where counsel can be helpful include:

- Assist in the drafting of the annual 15(c) letter to the Adviser
- Help Directors understand what peers are doing
- Talk to the portfolio management team, general counsel, and other integral members of the fund/Adviser's team
- Distill important topics for the Board and hold educational sessions as requested or necessary
- Help the Board understand the parameters of exemptive orders, including those involving co-investments and affiliated transactions

Internal education sessions provided by legal counsel can also be extremely helpful as the Board wades through new or existing issues. These may be particularly helpful in the case of:

- A newly launched fund
- Where a new asset class/type is acquired by the fund
- A fund strategy shift

- Board responsibilities surrounding liquidity and valuation of alternative investments[45]

The Board could ask for presentations from both the Adviser's portfolio management team and follow-up from fund and independent counsel. Lastly, counsel may also be useful in identifying industry-leading practices and making recommendations on ways in which a fund's processes may be enhanced.

FUND AUDITOR AND OTHER SERVICE PROVIDERS

The fund independent auditor can be a valuable resource to the fund Board due to its unique view into fund accounting, valuation, and disclosure. Specifically, the auditor reviews the accounting treatment and can potentially explain how an internal auditor reached a decision. A fund's independent auditor can also help the Board understand different tax implications for alternative asset classes, including international investments or offshore vehicles. Further, given their role, auditors can also provide broader industry insights in terms of leading practices.

Valuation services firms can also be a potential resource for the fund Board as they have a window into the valuation of illiquid assets. Valuation services firms can explain to the Board how the value of each type of asset is calculated and whether the Adviser's team reached a different calculation and why.

Conclusion

The Director's oversight role does not change when assets under management in a fund include alternative investments. The duties and responsibilities, however, may become more burdensome, complex and time-consuming. It is important that Directors recognize the challenges associated with alternative investments and structures but remain focused on carrying out their required oversight. The topics and questions discussed in this Paper can serve as a starting place for the increasing number of Directors who are overseeing these alternative products.

APPENDIX: WHAT ARE ALTERNATIVE INVESTMENTS?

Alternative investments include any assets outside of publicly-traded stocks, bonds, and cash, that are employed by a fund to achieve a particular strategy. These assets can be used to hedge market volatility or manage the risk of a certain position. While many assets can be considered alternative, the Paper highlights only a handful of these to provide a window into the alternative investment world. The list is not exhaustive and represents investments that have become increasingly popular in recent years.[46]

Private Credit

Private credit is a private loan or other debt instrument that is negotiated between a borrower and a non-bank lending party. The credit universe can cover direct lending, structured credit, and asset-backed finance, among others. These loans are often made to entities that lack access the traditional bank loan system and consequently, these loans tend to come with higher interest rates. In more recent years, the flexibility of private credit originators to offer bespoke terms to borrowers has resulted in certain non-bank lenders competing directly with banks in certain deals. Additionally, private credit is considered illiquid because there is not a traditional secondary market in which to offload the loan. Many lenders will hold the loan until maturity or a refinancing event. Additionally, private credit investments are often divided into different tranches based on the risk associated with each loan. The private credit market has soared in the last several years reaching an estimated $2.5 trillion in March 2025.[47]

Private Equity

Private equity is equity interest that does not freely trade on a public stock market, and is typically issued by startup companies, small businesses, and even well-established companies that have not yet gone public. Over time, however, as fewer companies have chosen to become public companies, the largest private companies have become bigger than many public companies. Like many entities, private companies regardless of size, search for capital investment and, by offering an investor a stake in the company, they can obtain funds to grow and/or advance their business. Private equity investments typically have a long-term orientation, focusing on long-term value creation rather than short-term price fluctuations.

Derivatives

A derivative is a financial contract between two parties where the value of the contract is derived from the underlying asset's performance. These contracts can use interest rates, currency exchange rates, commodities, and equity prices as the underlying asset. Derivatives are employed for a variety of reasons, including as a hedge against changes in market conditions, offsetting a specific investment position, leverage (magnifying a specific investment position), or more efficiently gaining exposure to a specific market. Some derivatives contracts may be illiquid and determining a fair value market price can be difficult.

Digital Assets

Due to the increasing popularity of digital assets among retail investors, Boards should be aware of their potential use in the asset management space. A digital asset broadly means a representation of value stored in digital form, such as cryptocurrencies, stablecoins, and non-fungible tokens ("NFTs") among others, with cryptocurrencies as the most prevalent currently. In 2024, several exchange-traded products ("ETPs") offering direct exposure to Bitcoin and Ethereum were launched in the United States.[48] These products do not offer the protections of the 1940 Act because they are not registered under the 1940 Act; rather, they are registered only under the Securities Act of 1933. These launches do, however, offer a glimpse into investor demand for such products.

Endnotes

[1] In this paper, the term "Adviser" is used broadly, and in certain cases, the term could include an underwriter/sponsor/administrator depending on the structure of the fund.

[2] "Fund" includes exchange-traded funds ("ETFs"), open-end funds, closed-end funds and business development companies ("BDCs") regulated under the Investment Company Act of 1940, as amended (the "1940 Act").

[3] This publication has been reviewed by MFDF's Steering Committee and approved by the MFDF Board of Directors, although it does not necessarily represent the views of all members in every respect. One representative from each member group serves on the MFDF Steering Committee. MFDF's current membership includes over 1040 independent directors, representing 159 mutual fund groups. Nothing contained in this report is intended to serve as legal advice. Each fund board should seek the advice of counsel for issues relating to its individual circumstances.

[4] 2024 EY Global Alternative Fund Survey, https://www.ey.com/content/dam/ey-unified-site/ey-com/en-gl/insights/wealth-asset-management/documents/ey-gl-ey-global-alternative-fund-survey-12-2024.pdf. The EY survey defines "global AUM" as "including private equity (PE) and credit, real estate, real assets and infrastructure, commodities, hedge funds and digital assets…"

[5] Retail Investment in Private Funds- Regulatory Obstacles and Opportunities. Ropes & Gray LLP. 2023 https://www.ropesgray.com/-/media/files/publications/2023/03/23_0434_bk_retail-investment-in-pf_0316.pdf?rev=1de2fd6ccd7d4627b55fe3d234344e5c&hash=8E116119AD864D72C07BEF7CF696F060#:~:text=The%20SEC%20staff%20has%20informally,sold%20only%20to%20accredited%20investors.

[6] Securities and Exchange Commission. (2025) ADI 2025-16 - Registered Closed-End Funds of Private Funds. https://www.sec.gov/about/divisions-offices/division-investment-management/fund-disclosure-glance/accounting-disclosure-information/adi-2025-16-registered-closed-end-funds-private-funds.

[7] Paul Atkins, Chairman, Prepared Remarks Before SEC Speaks, May 19, 2025, https://www.sec.gov/newsroom/speeches-statements/atkins-prepared-remarks-sec-speaks-051925

[8] Graber, Sean; Freese, David W.; and Nassauer, Christine M. "Interval Funds: An Alternative to 'Liquid Alternative' Funds? Part 1" The Investment Lawyer. Vol. 22, No. 9. September 2015.

[9] 17 CFR § 270.23c-3 - Repurchase offers by closed-end companies.

[10] 17 CFR § 240.13e-4 - Tender offers by issuers.

[11] Pangas, Harry S. "Everything you Need to Know About BDCs." Dechert LLP. (2020) https://www.dechert.com/content/dam/dechert%20files/people/bios/p/harry-pangas/HarryPangasAllYouNeedToKnowAboutBDCs.pdf

[12] Consolidated Appropriations Act, Pub. L. No. 115-141; 132 Stat. 348 (2018).

[13] Willkie, Farr & Gallagher LLP. Why More Alternative Asset Managers Should Embrace the 1940 Act. (2023). https://www.willkie.com/-/media/files/publications/2023/willkie-article-on-40-act-structures-for-alternative-asset-managers-v5.pdf

[14] 15 U.S.C. § 80(a)-2(a)(48).

[15] Guggenheim Investments. An Overview of Business Development Companies (BDCs) (2017), https://www.guggenheiminvestments.com/getattachment/Page-Types/UIT/BDCS010/An-Overview-of-Business-Development-Companies.pdf.aspx.

[16] Under section 2(a)(41) of the Investment Company Act of 1940, such securities must be assigned a "fair value" as determined in good faith by a fund's Board.

[17] Rule 2a-5(b).

[18] While this Paper will not go into depth on specific valuation requirements, MFDF and Stradley Ronon Stevens & Young, LLP published a paper in 2023 titled "Practical Guidance for Fund Directors on Valuation Oversight" which is available at https://www.mfdf.org/news-resources/news/2023/10/03/practical-guidance-for-fund-directors-on-valuation-oversight.

[19] Securities and Exchange Commission. (2021) Adopting Release: Good Faith Determinations of Fair Value at 54. https://www.sec.gov/files/rules/final/2020/ic-34128.pdf#page=73.

[20] *Id*. at 57.

[21] Securities and Exchange Commission. (2016) Adopting Release: Investment Company Liquidity Risk Management Programs. https://www.sec.gov/files/rules/final/2016/33-10233.pdf.

[22] *Id*. at 40.

[23] *Id*. at 318.

[24] *Id*. at 372.

[25] *See* 15 U.S.C. § 80a-18.

[26] Fidelity, *Leverage*, https://www.fidelity.com/learning-center/investment-products/closed-end-funds/leverage#:~:text=NAV%20returns%20can%20be%20negatively,of%2050%20million%20common%20shares.

[27] 17 CFR 270.18f-4 Use of Derivatives by Registered Investment Companies and Business Development Companies, published on December 21, 2020.

[28] *See* Use of Derivatives by Registered Investment Companies and Business Development Companies, SEC Release No. IC-34084 (Nov. 2, 2020), 85 Fed. Reg. 83162, https://www.sec.gov/resources-small-businesses/small-business-compliance-guides/use-derivatives-registered-investment-companies-business-development-companies-small-entity.

[29] 15 U.S.C. § 80(a)-5. Subchapter M of the Internal Revenue Code has a similar, but not identical diversification requirement. Subchapter M, discussed below, is the provision of the Internal Revenue Code that permits funds to distribute income and long-term capital gains to shareholders without incurring tax at the fund level.

[30] 15 U.S.C. § 80(a)-5(b)(1).

[31] 15 U.S.C. § 80(a)-5(b)(1).

[32] The ABA's Report of the Task Force on Investment Company Use of Derivatives and Leverage (available at http://apps.americanbar.org/buslaw/blt/content/ibl/2010/08/0002.pdf) discussed these issues, and recommended that the reference asset should be used for testing diversification, allowing for counterparty issues to be addressed under Section 12(d)(3) for all funds, including those that are not diversified. SEC Concept Release, Use of Derivatives by Investment Companies under the Investment Company Act of 1940, 76 Fed. Reg. 55237 (Sept. 7, 2011), https://www.sec.gov/rules-regulations/2011/08/use-derivatives-investment-companies-under-investment-company-act-1940 (requesting comment on the proper treatment of derivatives for purposes of diversification).

[33] 17 CFR § 270.13a-1

[34] FS Credit Opportunities Corp., et al., SEC No. IC-35561 (April 29, 2025) (order).

[35] MFDF also has valuable resources available online, in a publication titled, "Board Oversight of Advisory Agreement Renewals-Part 2: Board Processes" dated January 2025. *See,* https://www.mfdf.org/news-

resources/news/2025/01/07/mfdf-releases-board-oversight-of-advisory-agreement-renewals---part-2--board-processes. In addition, MFDF published "Board Oversight of Advisory Agreement Renewals - Part 3: Gartenberg Factors Analysis and Board Considerations" dated August 2025. *See*, https://www.mfdf.org/news-resources/news/2025/08/12/board-oversight-of-advisory-agreement-renewals---part-3--gartenberg-factors-analysis-and-board-considerations.

[36] Tailored Shareholder Reports for Mutual Funds and Exchange Traded Funds; Fee Information in Investment Company Advertisements, SEC Rel. No. IC-34731 (Oct. 26, 2022).

[37] Investment Company Names, Release No. IC-35000 (September 20, 2023) https://www.sec.gov/files/rules/final/2023/33-11238.pdf. While the rule became effective Dec. 11, 2023, the SEC has extended the compliance date for larger fund groups from Dec. 11, 2025 to June 11, 2026, and has extended the compliance date for smaller fund groups from June 11, 2026 to Dec. 11, 2026.

[38] *See* Section 8(b) of the 1940 Act.

[39] *See* Guide 19 of Form N-1A.

[40] *See* I.R.C. § 851-860.

[41] The diversification requirements for purposes of Subchapter M differ from diversification requirements under the 1940 Act.

[42] A common strategy is to use a Cayman Islands blocker subsidiary that is not subject to U.S. corporate income tax.

[43] For example, the Internal Revenue Code requires that with respect to 50% of the fund's assets, investments with respect to any one issuer generally may not represent more than 5 percent of the assets of the fund nor more than 10 percent of the voting securities of the issuer. In addition, the fund generally may not invest more than 25% of its assets in any one issuer (or two or more issuers that it controls and are engaged in the same or similar or related trades or businesses) or certain publicly traded partnerships. The fund may be limited in its use of blocker subsidiaries in order to ensure compliance with these diversification requirements.

[44] Rule 38a-1(a)(4)(iv).

[45] MFDF also has valuable resources available online, in a publication titled, "Practical Guidance for Fund Directors on Valuation Oversight" dated October 2023. *See*, https://www.mfdf.org/docs/default-source/default-document-library/publications/white-papers/mfdf---valuation.pdf?sfvrsn=d9bc3062_2.

[46] Other alternative assets include real estate, commodities, managed futures, options, and collectibles. For the sake of this Paper, the list is kept to a minimum to allow for a deeper discussion of a fund Board's responsibilities.

[47] Bank for International Settlements (BIS), Private Credit Market Overview, (Mar. 2025), https://www.bis.org/publ/qtrpdf/r_qt2503b.htm.

[48] Statement on the Approval of Bitcoin Exchange-Traded Products (Jan. 10, 2024), https://www.sec.gov/newsroom/speeches-statements/gensler-statement-spot-bitcoin-011023.