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HOW A FUND DIES

Steps in the liquidation of a mutual fund include a board resolution, shareholder approval in some cases, liquidation of assets, payout to shareholders, and de-registration under the 1940 Act. Special steps for certain funds are suspension of trading, de-listing, and suspension of 1934 Act reporting. The authors give an overview of the process for open-end, closed-end, and exchange-traded funds.

By Jack Murphy, Julien Bourgeois, and Lisa Price *

A registered management investment company (a "fund") may be liquidated as a result of a decline in assets under management, increased expenses, poor performance, or a combination of factors.[1] Market volatility, or the inability to attract a sufficient number of investors, has caused an increasing number of funds to cease operations and liquidate during the past several years. Since 2000, 2,994 open-end funds have liquidated, with 488 liquidating in 2009 alone, the highest number during the past decade.[2] Closed-end funds have displayed a similar pattern.[3]

Some fund boards and managers may not be acquainted with the mechanics of voluntarily liquidating and dissolving a fund; others may understand the process in principle, but may not have contemplated each step in detail. Because liquidation will result in the delivery of proceeds to shareholders, it is important to carry out the liquidation as smoothly and efficiently as possible. The purpose of this article is to provide an overview of the steps required to liquidate and dissolve a fund, whether an open-end fund, closed-end fund or exchange-traded fund ("ETF"), and to provide additional detail on parts of the process that may be less familiar.[4]

[1] For a further elaboration of the possible reasons for the liquidation and dissolution of a fund, s*ee* Stanley J. Friedman, *When a Fund Dies*, 626 PLI/CORP 861 (December 5, 1988).

[2] Investment Company Institute, INVESTMENT COMPANY HANDBOOK (2010), http://www.icifactbook.org/fb_ch1.html, Figure 1.9.

[3] In 2009, closed-end fund sponsors shut down 15 more funds than they opened, although the data do not specify whether these were liquidations, mergers, or some combination thereof.

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Sponsors of exchange traded funds however, opened more than 70 new funds, on a net basis, in 2009. *Id.*, Figure 1.10.

[4] This article focuses on voluntary liquidation. However, it should be noted that in some jurisdictions, such as Maryland, shareholders can also seek to liquidate and dissolve a fund without board approval, known under certain circumstances as an involuntary liquidation. *See, e.g.*, Maryland General

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INITIAL STEPS

Determining the Required Approvals for Liquidation and Dissolution

The first step in preparing for the voluntary liquidation and dissolution of a fund is to determine what approvals are required. A vote of the board of directors or trustees of the fund is typically needed, and a vote of shareholders may also be required. Voting requirements for the approval of liquidation and dissolution are generally set forth in state corporate or trust law (as applicable), in a fund's charter documents, or in both. Counsel should review both applicable law and the fund's charter documents as, in some cases, a fund's charter documents may override state law requirements. It is important to pay attention to this, so that a fund does not inadvertently comply with a higher standard for approval than is required by law, which could be costly and time consuming.[5]

Most funds are organized as Delaware statutory trusts, Massachusetts business trusts, or Maryland corporations. A brief summary of the relevant state law in these jurisdictions relating to liquidation and dissolution follows below.

Delaware Statutory Trusts. The Delaware Statutory Trust Act ("DSTA") provides that except as otherwise provided in the trust instrument, a statutory trust has "perpetual existence"[6] and "may not be terminated or revoked by a beneficial owner (*i.e.*, shareholder) or other person except in accordance with the terms of the trust instrument."[7] A statutory trust may also be organized or formed that does not have perpetual existence,[8] in which case the trust would be dissolved "upon the happening of events specified in the trust instrument."[9] A fund's trust instrument typically requires dissolution to be approved by a majority vote of the board of trustees of the trust without the need to obtain shareholder approval. A trust instrument may elaborate on the finding required of the board to liquidate the trust, including, for example, language that requires a finding by the board that the continuation of the trust is no longer in the best interests of the trust, as a result of factors or events adversely affecting the ability of the trust to conduct its business and operations in an economically viable manner.

Maryland Corporations. The MGCL provides that, as a general matter, if there are shares outstanding that are entitled to be voted on the dissolution, the board of directors of the corporation must, by a majority vote of the full board, (i) adopt a resolution declaring that dissolution is advisable,[10] and (ii) direct that the

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Corporation Law ("MGCL") Section 3-413. Many of the topics covered in this article would likewise be applicable to an involuntary liquidation.

[5] Section 13(a)(4) of the Investment Company Act of 1940 ("1940 Act") requires a shareholder vote in order for a company to "change the nature of its business so as to cease to be an investment company." The staff of the Securities and Exchange Commission ("SEC") has long taken the view that this section does *not* apply to a voluntary liquidation of a registered fund.

[6] As a matter of practice, while many trust instruments recite the "perpetual existence" of the trust that is codified under Delaware law, at the same time they also provide for a means by

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which the existence of the trust, or of a series thereof, may be terminated.

[7] DSTA Section 3808(a).

[8] Ann E. Conaway, *A Business Review of the Delaware Series: Good Business for the Informed*, 1677 PLI/CORP 645 (May 21, 2008). *See also* R. Franklin Balotti and Jesse A. Finkelstein, DEL. L. OF CORP. AND BUS. ORG. § 19.13 (2010).

[9] DSTA Section 3808(c). DSTA Section 3808(f) specifically provides that a series of a trust may be dissolved and its affairs wound up without causing the dissolution of the statutory trust or any other series.

[10] MGCL Section 2-112 permits a closed-end fund to include in its charter or prospectus a requirement that certain proposals relating to extraordinary corporate actions to eliminate or reduce the discount to net asset value (such as liquidation and dissolution of the fund) may be submitted to shareholders even if the board fails to recommend the proposal or declare it advisable or recommends that shareholders reject it. This could occur, for example, if a closed-end fund had an "automatic" liquidation and dissolution provision in its prospectus or

proposed dissolution be submitted to a vote of shareholders at an annual or special shareholders meeting.[11] Under the MGCL, dissolution must be approved by a vote of two-thirds of all votes entitled to be cast on the matter. However, the corporation's charter may establish a lesser shareholder voting requirement for dissolution (provided that the lesser voting requirement may not be less than a majority of all the votes entitled to be cast).[12]

Massachusetts Business Trusts. A Massachusetts business trust is a voluntary association organized by the execution and delivery by its trustees of a declaration of trust. The trust is created by agreement and not by statute.[13] Consequently, the trust must be dissolved according to whatever terms are specified in its Declaration of Trust. While it is possible to include a shareholder approval requirement, generally, a Declaration of Trust permits termination of the trust or a series without shareholder approval.

Shareholder Approval – Special Consideration for Closed-end Funds Having Senior Securities Outstanding

Closed-end funds are permitted under Section 18 of the 1940 Act to issue a class of senior security in the form of stock under certain conditions (open-end funds, by contrast, are prohibited from doing this). If state law or a fund's governing documents require shareholders to approve the liquidation and dissolution of a closed-end fund that has preferred stock outstanding, it will be necessary to examine the governing documents for that class of preferred stock (*e.g.*, articles supplementary) to determine whether a separate vote by holders of preferred shares is required. A separate voting requirement for preferred shares could make it more difficult and costly to obtain the required approval for liquidation and dissolution.

Preparing a Plan of Liquidation

After determining what approvals are required, the next step is to prepare a plan of liquidation and dissolution. The plan of liquidation sets forth all of the steps that will occur as part of the liquidation, and provides for the payment of any liabilities of the fund, including the setting aside of reserves for the payment of liquidation expenses, if such expenses are to be borne by the fund. The plan of liquidation should be approved by the fund's board of directors or trustees; it may also be approved by the fund's shareholders, if their approval is required for liquidation. It is important that the plan of liquidation specify in reasonable detail each of the steps that will be required in order to liquidate and dissolve the fund, as doing so will facilitate an orderly and complete liquidation.

CONSIDERATION AND APPROVAL OF LIQUIDATION AND DISSOLUTION

Board Consideration of Liquidation and Dissolution

Section 36(a) of the 1940 Act establishes a federal standard of fiduciary duty for directors (and others) when dealing with a fund, prohibiting acts or practices constituting a breach of fiduciary duty involving "personal misconduct" on the part of a director.[14] However, no specific provision of the 1940 Act or the rules thereunder governs board consideration and approval of liquidation and dissolution. Accordingly, state law is the primary source for determining the nature and extent of a board's responsibilities when considering liquidation and dissolution of a fund.[15]

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charter, pursuant to which a liquidation and dissolution proposal would be required to be submitted to shareholders (regardless of the board's views on the proposal) if the fund's average discount during a specified measuring period exceeds a certain amount. In this situation, the MGCL provides an exception from the requirements of MGCL 3-403(b) that the board adopt a resolution that dissolution is advisable. This provision has rarely been utilized by closed-end funds.

[11] MGCL Section 3-403(b). MGCL Section 3-405 allows a corporation to abandon or rescind the dissolution by following the same procedure required for its approval at any time before Articles of Dissolution are accepted in Maryland (as discussed further below). *See also* James J. Hanks, Jr., MARYLAND CORPORATION LAW 348 (2009).

[12] MGCL Sections 3-403(d) and 2-104(b)(5). A meeting notice stating that the purpose of the shareholder meeting is to act on a proposal to liquidate and dissolve the fund is also required to be given to shareholders. MGCL 3-403(c). This notice must meet the requirements of MGCL 2-504.

[13] Sheldon A. Jones, Laura M. Moret and James M. Storey, *The Massachusetts Business Trust and Registered Investment Companies*, 13 DEL. J. CORP. L. 421, 423 (1988). *See also* George Gleason Bogert, George Taylor Bogert, and Amy Morris Hess, THE LAW OF TRUSTS AND TRUSTEES, Section 247 (2010).

[14] *Tannenbaum v. Zeller*, 552 F.2d 402 (2d Cir. 1977).

[15] Some states, such as Maryland, have a statutory standard of conduct that is applicable to all actions to be considered by a director of a corporation, including liquidation. MGCL Section 2-405.1(a) requires that a director perform his or her duties (1) in good faith; (2) in a manner he or she reasonably believes

Regardless of the jurisdiction in which a fund is organized, to approve liquidation and dissolution, the board of directors or trustees of a fund must evaluate whether liquidation and dissolution is in the best interests of the fund. Directors or trustees are generally subject to a "duty of care" and a "duty of loyalty." Although it varies from state to state, the duty of care generally requires that a director or trustee act with a degree of diligence, care, and skill that a person of ordinary prudence would exercise under similar circumstances in a like position (and in a manner that the trustee reasonably believes is in the best interests of the fund and its shareholders). To satisfy the duty of care, the director or trustee must make a reasonable effort to become informed and familiar with the relevant and available facts regarding the proposed liquidation and dissolution, including the reasons for the proposal, the steps to be taken, the costs involved, and the impact on shareholders. The duty of loyalty requires that a director or trustee act in the best interests of the fund and not in his or her own interests or in the interests of another person or organization. Directors and trustees are generally protected by the "business judgment rule" in making decisions affecting the funds they oversee. The business judgment rule (which applies to directors or trustees of funds just as it does to directors of operating companies), essentially provides that directors or trustees will not be subject to liability for their decisions, including a decision to liquidate and dissolve a fund, as long as the directors or trustees (i) acted in good faith; (ii) were reasonably informed; and (iii) reasonably believed that the actions they took were in the best interests of the fund and its shareholders.[16]

As a practical matter, to enable directors or trustees to fulfill their responsibilities, they should be provided with details about the terms of, and rationale for, the proposed liquidation and dissolution. Directors or trustees should also be provided with information regarding the viability of alternatives to liquidation, including inaction or reorganization of the fund into another fund.[17] Board deliberations relating to liquidation should be well documented in order to protect the fund, the fund manager and the board itself, and to establish a solid foundation for the decision to liquidate, in the event of litigation. In at least one instance, shareholders have brought suit against a fund and its investment adviser regarding a decision to liquidate.[18]

Shareholder Consideration of Liquidation and Dissolution (if Applicable)

If it is necessary to obtain shareholder approval of the liquidation and dissolution, the fund will have to call a shareholder meeting and conduct a proxy solicitation in order to seek the required vote. A vote on liquidation and dissolution may be taken at either an annual or a

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to be in the best interests of the corporation; and (3) with the care that an ordinarily prudent person in a like position would use under similar circumstances. MGCL 3-410(d) provides that this is the appropriate standard of conduct for a director's consideration of liquidation. The duties and responsibilities of the trustees of a Massachusetts business trust are considered to be similar to those of the directors of corporations, and trustees are advised to look to Massachusetts corporation law with regard to standards of fiduciary duty. *See*, *e.g.*, *Richardson v. Clarke,* 364 N.E.2d 804, 806-7 (Mass. 1977) ("Business trusts possess many of the attributes of corporations and for that reason cannot be governed solely by the rules which have evolved for traditional trusts") and *Swartz v. Sher*, 344 Mass. 636, 184 N.E.2d 51 (Mass 1962) ("this type of business organization in practical effect is in many respects similar to a corporation"), *cited in* William K. Sjostrom, Jr., *Tapping the Reservoir: Mutual Fund Litigation under Section 36(a) of the Investment Company Act of 1940*, 54 U. KAN. L. REV. 251 (October 2005)) (discussing a director's fiduciary duties under state law). In Delaware, typically the declaration of trust specifies a fiduciary standard, and if it does not, DSTA Section 3809 provides that the law of trusts applies. For the standard of conduct applicable under the law of trusts, *see* DEL. CODE. ANN., Tit. 12, Section 3302(a); s*ee also* Robert A. Robertson, FUND GOVERNANCE: LEGAL DUTIES OF INVESTMENT COMPANY DIRECTORS (2006), Ch. 2.

[16] *See, e.g., McMullin v. Beran*, 765 A.2d 910, 916 (Del. 2007).

[17] In the case of a closed-end fund that may be considering liquidation as a result of a persistently high trading discount, alternatives to liquidation could include conversion to an interval fund, open-ending the fund, or other measures to address the discount, such as conducting one or more tender offers, implementing a managed distribution policy, or other similar actions.

[18] *Hines v. ESC Strategic Fund, Inc*. (1999 U.S. Dist. LEXIS 15790). In *Hines*, the board had determined, on the recommendation of the adviser, to liquidate a series of an open-end fund approximately two years after it commenced operations because the series had failed to attract sufficient investors and, due to its small asset size, operated with a high expense ratio. Plaintiffs alleged that the fund's prospectus failed to disclose that the fund could cease operations a relatively short period of time after commencing operations despite being held out as suitable for long-term investors. Plaintiffs sought a return of front-end sales charges paid by investors, as well as compensation for investment losses. While many of plaintiffs' claims were dismissed by the court, several claims survived, and the case was ultimately settled.

special shareholder meeting. While a detailed discussion of obtaining a shareholder vote on liquidation is beyond the scope of this article, care should be taken that the procedures set forth in the fund's governing documents are followed in calling the shareholder meeting,[19] and that proxy materials are prepared and the solicitation is conducted in accordance with the requirements of Section 14(a) of the Securities Exchange Act of 1934 ("1934 Act") and the rules thereunder.

MECHANICS OF LIQUIDATION AND DISSOLUTION

Announcement of Liquidation to Shareholders and the General Public

Once the required approvals for liquidation and dissolution have been obtained, the fund should announce the liquidation to shareholders. The announcement can take several forms. Some jurisdictions, such as Maryland, require the mailing of a written notice of liquidation to shareholders and known creditors of the fund.[20] In other jurisdictions, such as Delaware or Massachusetts, notice of liquidation to shareholders is not required by statute[21] and may not be covered in a fund's charter documents. Nevertheless, a fund may choose to require notice to shareholders in its plan of liquidation. For an open-end fund, the approval of liquidation is typically considered a material event that should be disclosed to shareholders in a supplement to the fund's prospectus or "sticker" filed with the SEC pursuant to Rule 497 under the Securities Act of 1933 ("1933 Act"). Funds with shares that trade on an exchange, such as closed-end funds or ETFs, generally announce the approval of liquidation to the public by issuing a press release, since liquidation could be deemed to be an event that "might reasonably be expected to materially affect the market for the fund's shares"[22] as well as a "corporate action" resulting in the "redemption, retirement, or cancellation of a listed security."[23]

Regardless of its form, notice of liquidation typically outlines the most significant steps that will be taken to effect the liquidation, such as: (1) the process of converting portfolio securities to cash or cash equivalents, and determining and paying (or setting aside) the amount of the fund's known or reasonably ascertainable claims and obligations; (2) the date and time as of which the fund will be closed to new investments, or its shares will no longer be transferable (as discussed further below); and (3) the timing of payment of liquidation proceeds to shareholders.

For open-end funds that issue redeemable securities, the notice of liquidation and/or supplement to the prospectus typically also covers how purchases, redemptions, and exchanges of fund shares may be conducted during the transition period prior to the closure of the fund, and whether any deferred sales charges or redemption fees will be applicable during this period. For closed-end funds that may have preferred stock outstanding, the notice discusses any liquidation preference to which preferred shareholders may be entitled, which would be paid in advance of the liquidating distribution to common shareholders.

Commencement of Conversion of Portfolio to Cash/Cash Equivalents; Payment of Debts, and/or Setting Aside of Reserves

A plan of liquidation typically becomes effective as soon as the required approvals for liquidation are obtained.[24] At that time, the fund effectively ceases its business as an investment company, and the fund manager begins the process of paying all known or reasonably ascertainable claims and obligations against the fund, or setting aside reserves for such purpose to

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[19] These may include, for example, the following board actions: (1) setting a record date for the meeting; (2) calling the meeting to be held on a specified date for the approval of liquidation and dissolution; (3) approving the filing of the proxy statement; (4) appointing attorneys and agents to be named as proxies; (5) appointing proxy solicitors; (6) approving the use of electronic/internet voting; and (7) appointing inspectors of election.

[20] MGCL 3-404.

[21] DSTA Section 3808 does not require that notice of dissolution be provided to shareholders of a Delaware statutory trust. *See also* Balotti and Finkelstein, *supra* note 7. With respect to a Massachusetts business trust, the statute that governs voluntary associations (*i.e.*, those formed by agreement, rather than by statute), also does not provide for any notice of liquidation to shareholders. MASS. GENERAL LAWS, Chapter 182, Section 12.

[22] *See, e.g.*, NYSE Listed Company Manual 202.05. Section 401 of the American Stock Exchange ("NYSE Amex") Company Guide imposes a similar requirement.

[23] *See, e.g.*, NYSE Listed Company Manual 204.22.

[24] Upon the approval of liquidation, open-end funds frequently choose to immediately suspend the sale of fund shares in recognition of the consequences to shareholders. Certain automatic purchases by existing shareholders may be allowed to continue if it is not practical to terminate contributions from certain categories of existing shareholders immediately.

cover such expenses. If the fund is to bear the costs of the liquidation itself, the fund will also need to estimate those costs, and to set aside sufficient funds for the payment of liquidation-related expenses such as printing, accounting, transfer agency, custodian, and other fees. In the case of an open-end fund, any reserve to cover the costs of liquidation should be established as soon as possible so that the costs of liquidation are deducted from the net asset value of the fund's redeemable securities.

As debts are paid or reserves set aside for that purpose, the fund also begins the process of converting its portfolio securities to cash and cash equivalents.[25] Depending on the nature of the fund and its investment objective and strategies, it may hold some illiquid positions that present unique or challenging issues with respect to their disposition. Fund managers should consider the type of securities held in the liquidating fund's portfolio, and allow sufficient time to address any issues arising from illiquid positions. It may be necessary to involve counsel in determining the appropriate steps that must be taken to dispose of certain holdings.

Closing or Cessation Date

A plan of liquidation typically requires the board of directors or trustees of a fund to establish a date as of which investors will no longer be able to invest in the fund. As discussed below, this date has slightly different implications in the open-end fund, closed-end fund, and ETF contexts.

For an open-end fund, the "Closing Date" (also sometimes called the Liquidation Date) is generally the date on or after which the open-end fund will distribute all of its remaining assets *pro rata* to shareholders of record. Prior to the Closing Date, shareholders can redeem their shares of the fund at net asset value and can also typically exchange fund shares for other funds within the fund complex at net asset value without imposition of an initial sales charge, redemption fee, or contingent deferred sales charge.[26] On or after the Closing Date, and thereafter, shares will no longer be regarded as outstanding.

For a closed-end fund or an ETF whose shares trade on an exchange, the "Cessation Date" is generally the date on which the fund's books are closed with respect to common shareholders. The proportionate interest of each common shareholder is fixed on the basis of his or her respective stockholdings at the close of business on the Cessation Date. As discussed further below, on the first business day following the Cessation Date, the fund's shares are suspended from trading on the relevant exchange, and can no longer be traded on the exchange after that date.

In establishing an appropriate Closing Date for an open-end fund or Cessation Date for a closed-end fund or ETF, the board should take into account the liquidity of the portfolio, the ease with which it will be possible to convert all assets to cash or cash equivalents, and the recommendations of the portfolio manager(s) on these issues. The length of time between the approval of liquidation and the Closing Date or Cessation Date will depend entirely on the structure and type of fund, and the fund's investment objective and strategy. Since in both the open-end and closed-end fund contexts, the Closing Date or Cessation Date serves as the record date for determining shareholders that are entitled to receive the fund's liquidation proceeds, it is best practice (or in the case of exchange-listed funds, may be required)[27] to announce the date in a press release or other similar announcement as soon as possible after the plan of liquidation is approved.

Special Considerations for Exchange-listed Funds

Suspension of Trading, De-listing, and De-registration

Closed-end funds and ETFs whose shares are traded on an exchange, such as the NYSE, the NYSE Amex, or the NYSE Arca, are required to undertake, in connection with a liquidation and dissolution, the additional steps of (i) suspending share trading on the exchange, (ii) removing shares from listing on the exchange, and (iii) withdrawing shares from registration under the 1934 Act.

Shares issued by exchange-listed funds are registered under Section 12 of the 1934 Act. Section 12(d) provides in relevant part that "a security registered with

[25] An ETF that tracks an index may experience increased "tracking error" as its portfolio is converted to cash and cash equivalents. The ETF may wish to consider disclosing this possibility in connection with the announcement of liquidation to shareholders.

[26] An open-end fund that is liquidating and dissolving often also waives contingent sales charges on redemptions and purchases of fund shares following the announcement of liquidation but before the Liquidation Date.

[27] NYSE Listed Company Manual 204.06 (governing the disclosure to shareholders of the fixing of a date for closing of the transfer books).

a national securities exchange may be withdrawn or stricken from listing and registration in accordance with the rules of the exchange and, upon such terms as the [Securities and Exchange] Commission may deem necessary to impose for the protection of investors, upon application by the issuer or the exchange to the Commission…."

The SEC has adopted rules under Section 12 that govern the process of suspending the trading of fund shares on an exchange, removing shares from listing on the exchange ("de-listing"), and withdrawing such shares from registration ("de-registering") under the 1934 Act. These steps are discussed below.

Suspension of Trading. Rule 12d2-1 under the 1934 Act gives a national securities exchange the authority to suspend a class of security from trading "in accordance with its rules…" The NYSE usually treats liquidation and dissolution as a "corporate action event," which triggers the exchange's obligation to suspend trading in fund shares pursuant to Rule 12d2-1. Upon learning of a fund's approval of liquidation and dissolution and establishment of a Cessation Date, the NYSE will automatically suspend trading in fund shares effective on the first business day following the Cessation Date. Section 1003(c)(ii) of the NYSE Amex Company Guide provides that the NYSE Amex will initiate suspension and de-listing of a security where "liquidation of the issuer has been authorized."[28] Rule 5.5(g)(2)(c) of the NYSE Arca Rules provide that the NYSE Arca will "remove [fund shares] from trading and listing (if applicable) upon termination of the issuing Investment Company."

De-listing. Rule 12d2-2 sets forth several avenues for removing a class of security from listing on an exchange and terminating its registration under Section 12(b) of the 1934 Act. A national securities exchange may de-list and de-register a class of security pursuant to Rule 12d2-2(a) if certain specified circumstances are met. One of these circumstances, set forth in Rule 12d2-2(a)(3), is where "the instruments representing the securities comprising the entire class have come to evidence, by operation of law or otherwise, other securities in substitution therefor and represent no other right, except, if such be the fact, the right to receive an immediate cash payment…" Pursuant to this provision, the NYSE, NYSE Amex, and NYSE Arca[29] (as well as other exchanges) initiate the process of de-listing the common shares of a closed-end fund and de-registering those shares under Section 12(b) of the 1934 Act.[30]

In order to initiate the process of de-listing a fund's shares, the exchange files with the SEC an application on SEC Form 25. The NYSE has advised informally that the fund itself is permitted to, and should, advise the exchange of when it would like the application on Form 25 to be filed. There are no formal processes governing this dialogue with the NYSE, but fund managers are advised to make or confirm a Form 25 filing request in writing (whether in an e-mail, or otherwise) for recordkeeping purposes. The NYSE has also advised informally that the earliest possible date for the filing of Form 25 is the date on which trading in fund shares is suspended (*i.e.*, the first business day following the Cessation Date). An application on Form 25 to de-list a class of security from an exchange will be automatically effective 10 calendar days after its filing with the SEC (unless the SEC otherwise determines to delay it, as discussed below).[31]

[28] Section 1003(c)(ii) further provides that "where such liquidation has been authorized by stockholders and the issuer is committed to proceed, the [NYSE Amex] will normally continue trading until substantial liquidating distributions have been made."

[29] Section 1003(f)(ii) of the NYSE Amex Company Guide provides that the NYSE Amex will normally consider suspension and de-listing "if the entire outstanding amount of a class, issue, or series is retired through payment at maturity or through redemption, reclassification, or otherwise. In such event, the [NYSE Amex] may, at a time which is appropriate under all the circumstances of the particular case, suspend dealings in the security and, in the case of a listed security, give notice to the SEC, on Form 25, of the [NYSE Amex]'s intention to remove such security from listing and registration as required by Rule 12d2-2(a) under the Securities Exchange Act of 1934."

[30] Rule 12d2-2(c) allows an issuer to voluntarily de-list a class of its shares from an exchange and withdraw such shares from registration under Section 12; a voluntary de-listing may occur when the fund's shares are trading at an undesirably low volume on the relevant exchange, the exchange's fee structure is not favorable, or where the fund is listed on multiple exchanges and no longer wishes to pay multiple listing fees. Rule 12d2-2(c) is generally not deemed to be applicable in the case of liquidation and dissolution, however, as the exchange does not regard liquidation and dissolution as the type of event that triggers a "voluntary" de-listing and de-registration. Accordingly, the exchange will generally not require a fund that is liquating and dissolving to observe procedures relating to a voluntary de-listing request (such as those set forth in NYSE Listed Company Manual 806.00).

[31] Rule 12d2-2(d)(1).

1934 Act De-registration. The filing of Form 25 by the relevant exchange simultaneously initiates the process of de-registering a fund's shares under Section 12(b) of the 1934 Act. An application to withdraw the registration of a class of securities under Section 12(b) will be automatically effective 90 calendar days "or such shorter period as the Commission may determine, after filing with the Commission."[32]

It should be noted that the SEC has the authority to delay the effectiveness of an exchange's application to de-list and/or de-register a fund's shares under Rule 12d2-2(d)(3) under the 1934 Act in order to determine whether the application has been made in accordance with the rules of the relevant exchange. If the SEC decides to delay effectiveness, it will notify the exchange and the fund in writing. However, such delay is unlikely to take place in the situation of a fund that is liquidating and dissolving, where the exchange itself has initiated the de-listing and de-registration process (and is, therefore, presumably following its own rules).

Suspending a Fund's Reporting Obligations under the 1934 Act

Section 13(a) of the 1934 Act requires every issuer registered under Section 12 (which would include any closed-end fund) to file periodic reports with the SEC. In the case of a fund that is liquidating and dissolving, the fund's obligation to file any reports under Section 13(a) of the 1934 Act "solely because of the registration of its shares under Section 12(b) of the 1934 Act" is suspended as of the effective date of the de-listing of the fund's shares (*i.e.*, 10 calendar days after the filing of Form 25), pursuant to Rule 12d2-2(d)(5) under the 1934 Act.[33] However, Rule 12d2-2(d)(7) under the 1934 Act provides, in relevant part, that an issuer whose reporting responsibilities under Section 13(a) of the 1934 Act are suspended pursuant to Rule 12d2-2(d)(5) is nevertheless required to file any reports that would be required under Section 15(d) of the 1934 Act, but for the fact that the reporting obligations are suspended. Reporting obligations under Section 15(d) ordinarily do not apply to closed-end funds so long as their shares are registered under Section 12(b).[34] However, pursuant to Rule 12d-2(d)(7), Section 15(d) reporting obligations may be triggered once a fund's Section 13(a) reporting obligations are suspended. Therefore, it is also necessary for a fund to suspend any reporting obligations under Section 15(d). In order to do so, the fund must file a certification on Form 15 pursuant to Rule 12h-3 under the 1934 Act.

Rule 12h-3 under the 1934 Act provides, in relevant part, that a class of securities is eligible to have its Section 15(d) reporting obligations suspended if it is held of record by (i) less than 300 persons or (ii) less than 500 persons where the total assets of the issuer have not exceeded $10 million on the last day of each of the issuer's three most recent fiscal years. At the point in the liquidation process when a closed-end fund is prepared to file Form 15, it would typically have fewer than 300 shareholders of record, and therefore would fall into the former category. By filing Form 15, the fund is certifying that it "has filed all reports required by Section 13(a) [of the 1934 Act] (without regard to Rule 12b-25), for the shorter of its most recent three fiscal years and the portion of the current year preceding the date of filing Form 15, or the period since the [fund] became subject to such reporting obligation." If the fund later withdraws the Form 15 or it is denied, the fund must file with the SEC within 60 days all reports that would have been required if the Form 15 had not been filed.

With respect to the timing of the filing, the SEC staff has taken the view that "a Form 15 with respect to the class of securities being de-listed may not be filed prior to the effective date of the Form 25 for the de-listing since the reporting obligations pursuant to Sections 12(g) and 15(d) remain suspended until that date."[35] Therefore, the Form 15 may not be filed until at least 10 days following the filing of Form 25 by the relevant exchange.

It should be noted that even after an exchange-listed fund's 1934 Act reporting obligations are suspended, it may still have reporting obligations under the 1940 Act. Section 30(a) of the 1940 Act imposes on *all* funds an independent obligation to file such periodic reports as

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[32] Rule 12d2-2(d)(2).

[33] If the SEC, the exchange, or the fund itself delays the withdrawal from Section 12(b) registration pursuant to Rule 12d-2(d)(3), Rule 12d2-2(d)(5) under the 1934 Act provides that the fund must, within 60 days of such delay, file any reports that would have been required to be filed under Section 13(a) of the 1934 Act if the Form 25 had not been filed (as well as any reports that would be required to be filed during the period the withdrawal is delayed).

[34] Section 15(d) of the 1934 Act provides in relevant part that "the duty to file under this subsection shall be automatically suspended if and so long as an issue of securities of such issuer is registered pursuant to Section 12 of this title."

[35] *Compliance and Disclosure Interpretations*, Question 144.01, *available at* http://www.sec.gov/divisions/corpfin/guidance/exchangeactrules-interps.htm.

would be required of funds that are listed on an exchange, pursuant to Section 13(a) under the 1934 Act. Section 30(b) of the 1940 Act requires all funds to file with the SEC such reports as may be required by rule. Certain reporting obligations may continue until the fund is de-registered under the 1940 Act.[36]

Payment of Liquidation Proceeds

Once a fund has converted all, or nearly all, of its portfolio securities to cash or cash equivalents, and paid its debts or set aside reserves for that purpose, the fund may proceed to distribute its remaining assets to its shareholders. Following the payment of liquidation proceeds to common shareholders, the fund's common shares will no longer be deemed to be outstanding. Each shareholder of record as of the Closing or Cessation Date (as applicable) will receive a distribution (or distributions, if more than one is necessary) equal to the shareholder's proportionate interest in the net assets of the fund.

For an ETF that normally only redeems its shares in "creation unit" aggregations, typically the fund's governing documents provide the board of directors or trustees with the authority to alter the number of shares that constitute a creation unit, for the purposes of making liquidating distributions to individual shareholders of the ETF, rather than just creation unit holders.

For a closed-end fund, if the fund has preferred shares outstanding, it is necessary to consider any liquidation preference given to preferred shareholders under the governing documents for that class of stock (*i.e.*, articles supplementary). Typically, a preferred shareholder is entitled to receive a liquidation preference of a certain dollar amount per share, plus an amount equal to any accrued unpaid dividends on his or her shares. The liquidation preference to preferred shareholders must be paid before any distributions to common shareholders. A closed-end fund should establish a record date for the full payment of the liquidation preference. The fund should also take care to observe any other procedures prescribed by the 1940 Act and the fund's articles supplementary with respect to the redemption of outstanding preferred shares (such as, for example, the preparation of a notice of redemption to preferred shareholders, and the filing of Form 23c-2 under the 1940 Act at least 30 days in advance of the redemption date).[37] Once the liquidation preference has been paid to preferred shareholders, the fund can proceed to make one or more liquidating distributions to common shareholders.

If a fund has issued stock certificates for outstanding shares, it may be necessary to consider whether (i) it is necessary to ask shareholders to submit their stock certificates to the fund prior to receiving a liquidating distribution, or (ii) certificates can be canceled by the fund upon payment of the liquidation proceeds, regardless of whether stock certificates are tendered by shareholders. Today, most funds issue shares without stock certificates; however, if the fund has been in existence for some time, there may be stock certificates outstanding. State law typically does not address the question of whether stock certificates must be returned to the fund prior to a distribution. However, a fund's governing documents may provide guidance. As a matter of practice, many liquidating funds do require the return of stock certificates. Many also require that if a shareholder has lost his or her stock certificate, he or she must submit an affidavit and bond in order to protect the fund against the possibility that someone else presents the lost stock certificate to the fund for payment in the future. If there is no available guidance under either state law or a fund's governing documents on this matter, it may be advisable to consult with counsel and an experienced transfer agent to determine an appropriate course of action.

De-registration under the 1940 Act

After a fund has distributed its assets to shareholders (and, if relevant, has de-listed its shares from an exchange and de-registered them under the 1934 Act), the next step is to file with the SEC an application on Form N-8F seeking an order declaring that the fund is no longer an investment company under the 1940 Act, pursuant to Rule 8f-1 under the 1940 Act. Form N-8F requires a fund to provide certain information regarding expenses incurred in connection with the liquidation, how such expenses were allocated, and which entity has borne those costs (whether the fund itself, or a third party such as the investment advisor). Form N-8F must be signed by an officer of the fund.

The SEC staff may require a fund to amend its application on Form N-8F before the Commission will issue the order granting de-registration under the 1940 Act. Once the SEC staff has satisfied itself that the application is complete, it will publish a notice giving interested persons approximately 23 calendar days to

[36] For example, Instruction 6 to Form N-8F (the application to de-register as an investment company, as discussed further below) reminds funds of the obligation to file a final Form N-SAR with the SEC pursuant to Rule 30b1-1 under the 1940 Act.

[37] Rule 23c-2 under the 1940 Act.

request a hearing on an application for de-registration. Assuming that no one requests a hearing, an order de-registering the investment company is issued approximately 25 days after notice of the application has been published.

Required State Filings

Some states require a filing in order to formally dissolve the fund from a corporate law perspective. Maryland requires the filing of Articles of Dissolution with the State Department of Assessments and Taxation ("SDAT").[38] Upon their acceptance, the MGCL provides that the fund will continue to exist "only for the purpose of paying, satisfying and discharging any existing debts or obligations, collecting and distributing its assets, and doing all other things required to liquidate and wind up its business and affairs."[39] In Delaware, the DSTA requires the filing of a certificate of cancellation with the Secretary of State, containing (1) the name of the statutory trust; (2) the date of filing of its certificate of trust; (3) the future effective date or time of cancellation if it is not immediate upon filing of the certificate, and (4) any other information the board of trustees determines to include.[40] In Massachusetts, a fund must file a copy of the board resolution terminating the trust (including the exact date of termination), and must also file all Reports of Voluntary Associations and Trusts (due to be filed annually) that are owed prior to the date of termination,[41] with the Secretary of the Commonwealth of Massachusetts.[42]

TAX CONSIDERATIONS RELATING TO LIQUIDATION

Almost all registered investment companies elect to be taxed as a regulated investment company ("RIC") under Subchapter M of the Internal Revenue Code of 1986, as amended (the "Code"). A RIC that meets certain minimum distribution requirements is able to avoid tax at the fund level to the extent that it distributes its net income and net gains to its shareholders in a timely manner.[43] A RIC must satisfy certain requirements relating to the source of its income and the diversification of its assets.[44] A RIC is also able to flow through the character of long-term capital gains distributed to shareholders through designation of capital gain dividends in notices to shareholders within 60 days after the close of the RIC's taxable year. If certain requirements are met, a RIC is also able to designate the character of distributions of certain other items such as tax-exempt interest, qualified dividends, and foreign taxes eligible for the foreign tax credit.[45]

A fund taxed as a RIC that is liquidating and dissolving is required to satisfy the qualification requirements for RICs for its final taxable year (even if a short taxable year). Failure to satisfy the diversification requirements on the last day of a fund's tax year would disqualify the fund for RIC status for its entire tax year.[46] Accordingly, it is important to consider the timing of the fund's tax year end, relative to the other steps in the liquidation process, in order to be sure that the qualification requirements are satisfied on that date.

A liquidating fund taxed as a RIC must also distribute any undistributed net income or net gains in a timely manner in order to avoid tax at the fund level. Such distributions are normally made either prior to or at the same time as the final liquidating distribution. The liquidating RIC must also make required designations of the character of such distributions within 60 days after the close of the RIC's taxable year.

A fund will also be required to make certain federal and state tax filings after its dissolution. In addition to filing its final federal tax return, a liquidating fund should also file IRS Form 966. With respect to any required state filings, a fund should consult the taxation authorities in the jurisdiction in which it is organized in order to determine whether any filings must be made.

Each shareholder who receives a liquidating distribution will generally recognize gain (or loss) forfederal income tax purposes equal to the amount by

[38] Articles of Dissolution will not be accepted by the SDAT unless all personal property tax returns have been filed and any penalties paid.

[39] MGCL 3-408(b).

[40] DSTA Section 3810(d).

[41] MASS. GENERAL LAWS, Chapter 182, Section 12.

[42] *About Voluntary Association and Certain Trusts*, Corporations Division, *available at* http://www.sec.state.ma.us/cor/corpweb/corvol/volinf.htm.

[43] Code Sections 852, 4982.

[44] Code Section 851.

[45] Code Sections 852, 853, 854.

[46] A RIC that invests in tax-exempt municipal securities must have at least 50% of its total assets invested in such tax-exempt securities on the last day of each quarter of the RIC's taxable year, including on the last day of the taxable year, in order to pay tax-exempt dividends with respect to such year. Code Section 852(b)(5).

which the liquidating distribution exceeds (or is less than) the shareholder's tax basis in his or her liquidating fund shares.

Finally, it should be noted that additional tax considerations may apply depending on the nature of the fund's investment objective and strategy.

CONCLUSION

The liquidation and dissolution of a fund is a complex process that implicates a wide variety of corporate and federal laws and regulations. Whatever the reason behind the decision to liquidate, care should be taken during the process, so that proceeds are paid to shareholders in an orderly and timely fashion, and value thereby maximized. ■

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