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Closed-end Fund Primer

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Closed-end Fund Key Facts:

- SEC-registered and regulated under the Investment Company Act of 1940
- Structured as a regulated investment company (RIC) for tax purposes
- Limited share redemption enables the CEF to deploy more capital, rather than holding a high cash position
- Each closed-end fund (CEF) has a fixed number of shares
- Share prices are independent of the CEF's net asset value
- Can be NSCC-enabled

Closed-end Funds

A CEF is a professionally managed portfolio of securities generally structured as a regulated investment company. CEFs are in many ways comparable to—and sometimes confused with—the traditional open-end mutual fund. A CEF is a mutual fund, but is unlike the more familiar open-end mutual funds that can potentially issue an unlimited number of shares. A CEF can only issue a fixed number of shares once it has listed on the open market. This distinguishing characteristic—among the other differences between the two types of mutual funds—influences the respective fund's appeal to investors.

CEFs are registered with and regulated by the SEC

Like traditional mutual funds, CEFs are regulated by the Securities and Exchange Commission (SEC) and must comply with rigid operational guidelines and reporting requirements designed to protect investors. These regulations are outlined in the Investment Company Act of 1940, which is the established regulatory framework for the mutual fund industry.

CEFs typically receive tax advantages by operating as regulated investment companies

CEFs generally elect to be structured as a RIC for the tax benefits it provides to the fund. A RIC is a federal tax qualification under the Internal Revenue Code of 1986 that allows an entity to avoid taxation at the corporate level. This ability to operate as a pass-through entity helps CEFs to avoid double taxation on capital gains and dividends. Otherwise, both the entity and the investor would be required to pay federal income taxes on the income.

CEFs have a fixed number of shares on the open market

Shares for a CEF are primarily created during the fund's initial public offering (IPO) and are then fixed or limited on the open market. Once the IPO terminates, shares can only be purchased from other investors through secondary markets. In contrast, open-end funds may issue or redeem shares at will, with these funds continuously offering new shares directly to investors to meet demand. Open-end funds are often considered to be more liquid investments than CEFs. However, CEFs generally have a more stable capital base due to their limited inflow and outflow of capital. This characteristic could also help to limit yield fluctuations, which sometimes occur in open-end funds during periods of decreasing interest rates.

CEFs that have listed can maintain low cash positions allowing them to deploy more of their capital into investments

Since CEFs do not directly buy or sell assets once the fund is on the open market, many of these funds can maintain a lower cash position than open-ended funds because they have a limited need for continuous redemptions. This allows the fund to use more of its capital for investment purposes.

On the open market, CEF share prices are not determined by the fund's net asset value

A fund's net asset value (NAV) represents the value of its assets (less liabilities) divided by the number of shares outstanding. An open-end mutual fund's NAV determines its share price on a daily basis, so its trade value rises and falls in direct relation to the value of its underlying securities. On the other hand, a CEF's share price may be influenced by its NAV—but it is not exclusively determined by it. CEF shares trade based on supply and demand, and investor sentiment can push prices above or below a fund's NAV.

CEFs can be NSCC trading-enabled

The National Securities Clearing Corporation (NSCC) is a subsidiary of Depository Trust & Clearing Corporation and is regulated by the SEC. The NSCC provides centralized clearing, settlement and risk management for the financial services industry. Through the NSCC, brokers can offset buy-and-sell positions into a single payment obligation, thereby reducing financial exposure and capital requirements. The NSCC is the standard platform used by other closed-end mutual funds for trades in their common stock.The NSCC provides a central clearing and settlement platform, which enables streamlined trade matching, which increases the speed of settlement, accuracy and transparency.

Potential Benefits of CEFs

- Ability to invest in private equity and private debt securities in a mainstream 1940 Act structure
- CEFs have an operating history of more than 90 years[1]
- Defined offering periods that cannot be extended
- Eligible for fee-based accounts
- Typically do not pay corporate taxes and distribute substantially all of their income to investors
- Regulatory leverage limit of 33% of total assets
- Established investment vehicle in both private and public markets
- Consider listing on a national exchange immediately upon the conclusion of the offering. Other potential exit strategies could include a merger or sale of assets. Exit strategy is at the sole discretion of the Fund's Board of Directors and may require a shareholder vote. There is no assurance that a liquidity event will be completed within the targeted three-year offering period or at all.
- Provides retail-investor access to institutional-type investment opportunities that were previously less available

Potential Risks of CEFs

- Limited liquidity during offering period
- May not be NSCC-eligible during offering period
- Typically not actively managed in a fee-based account until listed
- The value of the securities within a CEF may increase or decrease in value, sometimes rapidly and unpredictably. The shares at any point in time may be worth more or less than the original investment.
- The selection of securities and other investment decisions made by a CEF manager might produce losses or cause a CEF to underperform compared to other funds with similar investment goals.
- This type of investment involves exposure to market risk, liquidity risk, and other risks associated with the use of moderate leverage.
- Economic and regulatory changes could have an adverse impact on a CEF's operating results.
- It is important to remember that income may fluctuate significantly based on exposure to, among other risks, credit risk, interest rate risk and currency rate risk. Investors should carefully read and consider the information in the Risk Factors section of the prospectus, and should also consider the fees and expenses of the issuer prior to making a decision to invest.

[1]McWhinney, James E., "A Brief History of the Mutual Fund." September 7, 2009; http://www.investopedia.com articles/mutualfund/05/mfhistory.asp.

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Published 04/16