WHAT A RELIEF! CO-INVESTMENTS GET EASIER FOR INTERVAL FUNDS, TENDER OFFER FUNDS, AND BUSINESS DEVELOPMENT COMPANIES

Date: 2 May 2025

US Asset Management and Investment Funds Alert

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The US Securities and Exchange Commission (SEC) has approved a streamlined framework for co-investments involving certain closed-end funds and business development companies (together, Regulated Funds).[1] This updated approach offers a more practical path for advisers managing both private funds and Regulated Funds, easing compliance burdens—particularly for boards of trustees or directors (each, a Board and collectively, Boards)—compared to the prior co-investment framework.

While the new framework does not address every challenge associated with co-investments by Regulated Funds, it represents a significant and welcome development. The relief has been well received across the industry,[2] and funds operating under existing co-investment orders should consider submitting amendments to align with the updated relief.

BACKGROUND

The new co-investment framework is outlined in an exemptive application submitted by FS Credit Opportunities Corp. et al. (FS), seeking an order to permit certain joint transactions among affiliated FS funds.[3] On 3 April 2025, the SEC issued a notice of its intent to grant the requested relief, which includes streamlined terms and conditions relative to prior co-investment orders. The SEC formally granted the order on 29 April 2025.[4]

KEY CHANGES

As noted above, the new conditions provide for significant flexibility in connection with co-investments. Among others, some of the key changes of the relief are as follows:

Streamlined Co-Investment Transaction Procedures

Pre-Existing Investments in an Issuer No Longer Outright Prohibited

Under the prior co-investment framework, Regulated Funds and their affiliates were prohibited from participating in an initial co-investment transaction if an affiliate already held a security of the same issuer.

- Under the new co-investment framework, a Regulated Fund may now participate in such a transaction where an affiliate already holds an investment in the same issuer, provided the Required Majority[5] of the Board approves the investment and makes specified findings regarding the transaction. In addition, Regulated Funds may acquire securities of issuers in which affiliates already hold interests—without

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Required Majority approval—if the Regulated Fund already holds the same security and all affiliated entities invest on a pro rata basis.

Reduction in Frequency of Board Approvals

Previously, a Regulated Fund's Board was required to approve: (i) each new co-investment transaction; and (ii) any follow-on investments or dispositions, unless the transaction was allocated on a pro rata basis or involved only tradable securities.

- Under the new co-investment framework, Board approval is required only when an affiliate of a Regulated Fund has an existing investment in the issuer and either: (i) the Regulated Fund does not already hold an investment in that issuer; or (ii) the Regulated Fund and its affiliates are not participating in the transaction on a pro rata basis relative to their existing holdings.

Elimination of "Board-Established Criteria" and Reduced Board Reporting Requirements

Board-Established Criteria

Under the prior co-investment framework, investment advisers were required to offer all potential co-investment opportunities that aligned with a Regulated Fund's investment objectives and any objective, "board-established criteria."

- The new co-investment framework eliminates this specific requirement. Instead, investment advisers may allocate co-investment opportunities to Regulated Funds based on their fiduciary duty and in accordance with their allocation policies. A Regulated Fund may participate in such transactions so long as the Board—including a Required Majority—has reviewed and approved the fund's co-investment policies and procedures.

Streamlined Reporting

Under the previous co-investment framework, advisers were required to submit detailed, transaction-specific quarterly reports. These reports included information on co-investment opportunities not offered to the Regulated Fund, follow-on investments and dispositions by affiliated entities, and any declined or missed opportunities.

- The new framework significantly reduces the reporting burden on advisers and chief compliance officers (CCOs). Advisers will now only need to provide periodic reports to the Regulated Fund's Board, in the form requested by the Board, along with a summary of any significant issues related to compliance with the relief. Additionally, the CCO will deliver an annual report to the Board outlining the Regulated Fund's participation in the co-investment program, affiliated entities' participation, and any material changes to the investment adviser's co-investment policies. The CCO will also be required to notify the Board of any compliance issues related to the relief.

Expanded Flexibility for Joint Ventures, Sub-Advised Regulated Funds, and 3(c) Funds

Joint Ventures

The new co-investment framework expands eligibility for participation in co-investment transactions by including joint venture subsidiaries (i.e., an unconsolidated joint venture subsidiary of a Regulated Fund, in which all

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portfolio decisions, and generally all other decisions in respect of such joint venture, must be approved by an investment committee consisting of representatives of the Regulated Fund and the unaffiliated joint venture partner, with approval from a representative of each required) of a Regulated Fund, formed with an unaffiliated joint venture partner. Previous co-investment relief generally did not allow such joint venture subsidiaries to participate in negotiated co-investments in reliance on the exemptive relief.

Sub-Advised Funds

Sub-advised Regulated Funds, where the primary adviser and sub-adviser are unaffiliated, can now participate in co-investment transactions. Previously, most exemptive orders did not allow these types of entities to participate in such co-investment transactions. A Regulated Fund may rely on the relief obtained by its adviser to co-invest with adviser affiliates, as well as the relief obtained by the applicable sub-adviser to invest with sub-adviser affiliates, by indicating to the Board which relief the Regulated Fund is relying on.

Broader Range of Affiliated Private Funds

The new framework extends to a broader array of affiliated private funds, permitting any entity that would be considered an investment company but for Section 3(c) of the Investment Company Act of 1940, as amended (the 1940 Act) or Rule 3a-7 thereunder to rely on the relief, provided it is advised by an adviser affiliated with the applicant. Previously, exemptive orders were generally limited to entities relying on Section 3(c)(1), 3(c)(7), or 3(c)(5)(C). Additionally, insurance company general accounts are now treated as private funds.

TAKEAWAYS FOR SPONSORS OF INTERVAL FUNDS, TENDER OFFER FUNDS AND BUSINESS DEVELOPMENT COMPANIES

Simplified Governance

The new co-investment framework adopts a more practical approach by eliminating the requirement for Board approval for nearly every investment. This change significantly reduces the governance burden, allowing Boards to focus on strategic oversight rather than routine transaction approvals. By streamlining the approval process, advisers can make investment decisions more efficiently, minimizing delays and administrative overhead.

Clearer Roles

The updates provide greater clarity regarding the respective roles of the adviser and the Board in investment decisions. This clearer delineation of responsibilities enhances governance and ensures smoother operations. More specifically, the new relief does not require that a Regulated Fund's Board be presented with all relevant co-investment transactions that were not made available to the Regulated Fund and an explanation of why such investment opportunities were not made available. Instead, the Regulated Fund's Board simply must (i) review the adviser's co-investment policies to ensure they are reasonably designed to prevent the Regulated Fund from being disadvantaged by participation in the co-investment program and (ii) approve policies and procedures that are reasonably designed to ensure compliance with the terms of the new relief.

Expanded Investment Opportunities

Regulated Funds can now participate in a broader range of investment opportunities, even if an affiliate already holds an investment in the same issuer where the Regulated Fund has not previously participated. The ability to

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engage in follow-on investments without requiring stringent Board approval further enhances the flexibility and appeal of co-investment opportunities, broadening access to private markets for retail investors.

Efficient Allocation

The new framework eliminates cumbersome requirements for special allocation determinations, placing the allocation process squarely within the adviser's fiduciary responsibility.

The New Co-Investment Framework Facilitates Private Fund to Regulated Fund Conversions

The updated co-investment framework removes the “pre-boarded assets” distinction, facilitating the conversion of private funds to Regulated Funds. This change reduces the burden on converted assets, lowers associated costs, and eliminates the need for independent counsel with respect to these pre-boarded assets, further alleviating financial and administrative burdens.

If you have any questions on co-investments or want further advice on taking advantage of the new relief, please do not hesitate to contact the authors listed in this alert.

FOOTNOTES

[1] *See* SEC, Investment Company Act Release No. 35520; File No. 812-15706 (Apr. 3, 2025), available here.

[2] *See* Letter from Paul G. Cellupica & Kevin Ercoline, Inv. Co. Inst., to Vanessa Countryman, SEC (Mar. 4, 2025), available here.

[3] *See In re* FS Credit Opportunities Corp., No. 812-15706 (Feb. 20, 2025), available here.

[4] *See* SEC, Investment Company Act Release No. 35561; File No. 812-15706 (Apr. 29, 2025), available here.

[5] As defined in Section 57(o) of the 1940 Act.

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KEY CONTACTS



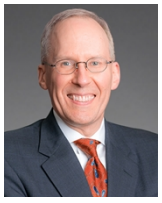
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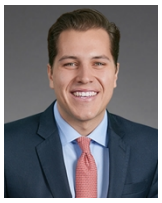
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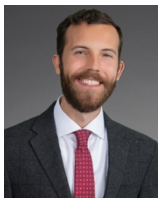
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