Proskauer

SEC Staff Clears Path for Third-Party Warehousing to Seed New Registered CEFs and BDCs

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On October 29, 2026, the staff of the SEC Division of Investment Management issued a no-action letter (the "Letter") that expressly accepts a third-party warehousing arrangement for building the initial portfolio of a new registered closed-end fund or business development company (any such vehicle a "Fund").

Why It Matters

Funds distributed through wealth channels often struggle at launch. Private assets take time to source, so early investors bear the cost of uninvested cash. Distribution platforms also often require a Fund to reach certain capital or portfolio-construction thresholds before offering it. The joint-transaction prohibitions of the Investment Company Act of 1940, as amended (the "1940 Act")[1] have historically presented an impediment, which can be addressed by warehousing assets based on a staff-endorsed framework set out in the Letter.

The Structure

A Fund and its sponsor (the "Sponsor"), together with any affiliate providing the equity commitment described below, will enter into a single agreement (the "Facility Agreement") with a single unaffiliated warehouse provider (the "Warehouse Party"). The Sponsor will present investment opportunities to the Warehouse Party, and the Warehouse Party will decide, in its sole discretion, which to acquire. The Warehouse Party will hold the assets as owner of record and may keep the income they produce. The Warehouse Party will agree to sell the entire portfolio to the Fund once two conditions are met: (i) the Fund reaches its minimum offering amount and (ii) the Fund's board approves the purchase. The Facility Agreement will terminate once the Fund buys the portfolio or the Fund's board declines it.

Key Terms and Conditions

Pricing. The Fund will pay the lower of:

- **Net cost:** the Warehouse Party's cost, minus distributions it received, plus financing fees and certain tax and foreign currency amounts; or
- **Fair value:** the aggregate fair value at the time of purchase, as determined by the Sponsor under Section 2(a)(41) and Rule 2a-5.

If fair value at the time of purchase is below net cost, the Sponsor or an affiliate must pay the difference to the Warehouse Party, without reimbursement from the Fund; if it is above net cost, the resulting unrealized gain benefits the Fund's net asset value. If the Warehouse Party sells any asset to a third party at a profit, the profit reduces the Fund's purchase price for the rest of the portfolio.

Unaffiliated counterparty and sourcing. The Warehouse Party may not be a first- or second-tier affiliate of the Fund. It also may not buy assets from any such affiliate or from any account managed by a Sponsor affiliate.

All-or-nothing purchase. The Fund must buy every warehoused asset, except assets that cannot be transferred for reasons outside the parties' control (e.g., sanctions). Before the Fund's board makes its decision, the Warehouse Party may sell assets to third parties but not to affiliates of the Sponsor. If the Fund's board declines, affiliates of the Sponsor may then buy the portfolio.

Two board approvals.

- **Entering the facility:** The Fund's board must approve the Facility Agreement and its costs after receiving a copy. If the Fund's board has not yet been fully constituted, the sole initial trustee may approve it, subject to later ratification by the full board.
- **Buying the portfolio:** The Sponsor and the Fund's board must each determine that the terms, including price and financing fees, are reasonable and fair and do not involve overreaching, and that the acquisition is in the Fund's best interests and consistent with its investment objective and strategies.

For Funds that are not business development companies ("BDCs"), the board determinations must be made by a "required majority" (as defined in Section 57(o) and applied as if the Fund were a BDC), and the Fund must maintain records required by Section 57(f)(3) as if it were a BDC. Board materials must be kept for the life of the Fund and are subject to SEC examination.

Disclosure. The Fund's initial offering materials must include:

- a Regulation S-X Rule 12-12 schedule of the warehoused investments;
- the material terms of the Facility Agreement;
- the valuation methodology at purchase, including whether an independent valuation firm or pricing service will be engaged;
- the treatment of the arrangement under Section 18; and
- the related risks and conflicts of interest.

If the Fund's board declines the portfolio, the offering materials must be amended to identify the declined assets and state that the Fund's board declined them.

Equity backstop. If the Fund does not reach its minimum offering amount by a set date, an affiliate of the Sponsor will buy enough Fund shares for cash, on the same terms as unaffiliated investors, to meet the minimum. The SEC staff did not provide assurance that the equity backstop complies with the 1940 Act and acknowledged that future warehousing arrangements may not include one.

Co-Investment Order Overlay

The relief is available only to Funds whose co-investment exemptive orders have terms and conditions substantially identical to the streamlined orders modeled on the April 2025 FS Credit Opportunities Corp. exemptive order (an "Order").[2] For warehoused assets that would have required co-investment relief had the Fund invested directly:

- The Sponsor may recommend only deals that comply with the Order.
- While the Warehouse Party holds the asset, the Sponsor must treat it as the Fund for allocation and disposition purposes.
- After the Fund buys the asset, the Fund and Sponsor must comply with the Order as if the Fund had acquired the asset directly.
- The Fund's board must receive the reporting required under Condition 7 of the Order.

Differences for BDCs

For BDCs, the Section 57 affiliation framework replaces the Section 17 tests:

- **Affiliation:** The Warehouse Party may not be a Section 57(b) affiliate (i.e., a controlling or close affiliate) of the BDC. A more remote Section 57(e) affiliate is permitted if a required majority of the BDC's board takes the Section 57(f) steps before the BDC enters into the Facility Agreement (or, if the initial trustee signed it, ratifies it once the full board is seated).
- **Sourcing:** The Warehouse Party may not buy assets from Section 57(b) affiliates of the BDC, and may buy from Section 57(e) affiliates only if a required majority takes the Section 57(f) steps before the BDC buys the asset.

Observations

The fair value determination carries a built-in conflict. Under the pricing formula, a higher fair value reduces the Sponsor's shortfall payment and increases the amount the Fund pays. Because the Sponsor typically determines fair value, Fund boards should scrutinize the purchase-date valuation, consider requiring an independent valuation firm or pricing service, and document that review under their Rule 2a-5 oversight framework.

The Sponsor bears the downside. Because the Sponsor absorbs value declines during the warehouse period, the structure is best suited to performing credit and other lower-volatility strategies.

Financing fees reduce Fund returns. The Fund bears the warehouse financing fees, which may affect performance and the calculation of management and incentive fees. Boards should consider these effects when making the required fairness finding.

Issues the staff did not address. The staff gave no assurance on Section 18 or Rule 18f-4. Sponsors should consider whether the Fund's conditional purchase obligation is an unfunded commitment agreement and how the Fund will satisfy the "reasonable belief" standard for sufficient cash, particularly absent an equity backstop.

Limits on scope. The relief applies only at launch and does not cover ramping up an existing Fund.

Proskauer regularly advises sponsors, independent directors and warehouse providers on registered closed-end fund and BDC launches, co-investment relief and affiliated-transaction matters. Please contact any of the lawyers listed below or your regular Proskauer contact with questions.

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[1] Unless otherwise specified, all section and rule references herein are to the 1940 Act and the rules thereunder.

[2] *See* FS Credit Opportunities Corp., et al., Investment Company Act Release Nos. 35520 (Apr. 3, 2025) (notice) and 35561 (Apr. 29, 2025) (order).

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