

April 2020

Follow @Paul\_Hastings



## *SEC Adopts Offering Reforms for BDCs and Registered Closed-End Funds and Issues a Temporary Exemptive Order*

By [Investment Management Practice](#)

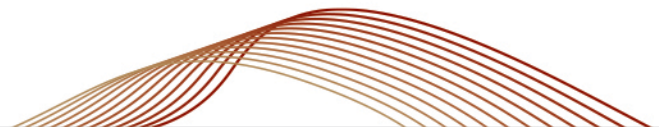
On Wednesday, April 8, 2020, the Securities and Exchange Commission (the “SEC” or the “Commission”), by a 3-1 vote, approved rule amendments (“Adopted Rules”) extending to business development companies (“BDCs”) and registered closed-end funds some of the more efficient registration, reporting, offering, and communication requirements currently applicable to operating companies.<sup>1</sup> On the same day, the Commission also issued an Exemptive Order<sup>2</sup> providing regulatory flexibility to BDCs in light of the difficult market conditions caused by the coronavirus (“COVID-19”) outbreak. Subject to the conditions outlined in the Order, a BDC would be permitted to issue and sell senior securities and participate in certain joint enterprises or other joint arrangements that would otherwise be prohibited by section 57(a)(4) of the Investment Company Act of 1940, as amended (the “1940 Act”), and Rule 17d-1 thereunder.

### **Adopted Rules: Key Takeaways**

The Adopted Rules are a result of a Congressional mandate<sup>3</sup> directing the Commission to amend its rules to create parity between the treatment of BDCs and registered closed-end funds with that of operating companies. In his statement at the open meeting, SEC’s Chairman Clayton noted that the intention of the rule amendments is to promote the following: (1) capital formation with respect to the BDCs and closed-end funds and small businesses in which they invest; (2) timely provision of information to shareholders of BDCs and closed-end funds; and (3) protection of investors.

The following are some of the key takeaways from the rule and form amendments:

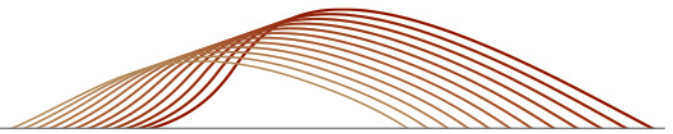
1. **Short Form Registration.** In an effort to streamline registration, certain BDCs and closed-end funds may use a short-form registration statement if they meet certain reporting history requirements and a public float of \$75 million or more. The Adopting Release defines public float as the aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant.<sup>4</sup> BDCs and closed-end funds that take advantage of this option must disclose material unresolved SEC staff comments and closed-end funds must provide management’s discussion of fund performance in their annual reports.<sup>5</sup>



2. **Well-Known Seasoned Issuer Status.** Certain BDCs and closed-end funds may qualify as well-known seasoned issuers (known as “WKSIs”) if they meet certain reporting history requirements and a public float of \$700 million or more.
3. **Immediate Effectiveness for Certain Filings.** BDCs and closed-end funds that conduct continuous security offerings will fall under the scope of rule 486 of the Securities Act of 1933, as amended (the “1933 Act”). This will allow for certain changes to registration statements to become effective either immediately upon filing or automatically after filing.<sup>6</sup>
4. **Prospectus Delivery Reform.** BDCs and closed-end funds will satisfy final prospectus delivery requirements by filing the prospectus with the Commission. Other delivery reforms included allowing the use of a free writing prospectus and forward-looking statements.
5. **Data Reporting Requirements.** BDCs and closed-end funds must submit cover page information and certain prospectus disclosure using XBRL format. BDCs will also be required to submit financial statement information using the Inline eXtensible Business Reporting Language (“XBRL”) format to the extent required by operating companies. These requirements will take effect August 1, 2022 for those that use short-form registration statements, and on February 1, 2023 for all other BDCs and closed-end funds.
6. **Incorporated by Reference Requirements.** BDCs and closed-end funds may refer to incorporated materials by making it readily available on a website, as opposed to the current standard of requiring funds to provide new purchasers a copy of all previously filed materials that were incorporated by reference into a registration statement.
7. **Rule 415.** Amended rule 486 would allow a fund that files a new registration statement every three years under rule 415(a)(5) and (a)(6) to have its registration statement be immediately or automatically effective under the rule, depending on the substance of the disclosure.<sup>7</sup> For example, a registration statement filed to comply with rule 415(a)(5) and (a)(6) could be immediately effective upon filing if it is filed for no purpose other than to comply with those provisions of rule 415 or for other purposes listed in rule 486(b), such as making non-material changes or updating the fund’s financial statements under section 10(a)(3). However, if the registration statement does not qualify under rule 486(b) because, for example, it includes material changes to the fund’s disclosure, the registration statement could be automatically effective 60 days after filing under rule 486(a). As a result of the amendments, affected funds that make continuous offerings under rule 415(a)(1)(ix) will be able to rely on rule 486 for registration statements filed to comply with rule 415(a)(5) and (a)(6), regardless of whether they choose to register additional shares at the time these provisions requires them to file new registration statements.<sup>8</sup>

The Adopted Rules apply to listed and unlisted<sup>9</sup> BDCs and closed-end funds. The Adopted Rules, however, will apply differently to affected funds. Some of the provisions will apply to all affected funds while other provisions will apply only to affected funds that are also seasoned funds. Affected funds include all BDCs and registered closed-end funds, including interval funds. Under the Adopted Rules, an affected fund would be:

- Permitted to publish factual information about the offering, including “tombstone ads”;



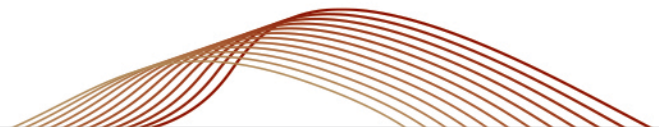
- Permitted to communicate without risk of violating the gun-jumping provisions until 30 days prior to filing a registration statement;
- Permitted to publish and disseminate regularly released factual and forward-looking information;
- Permitted to use a “free writing prospectus”; and
- Required to tag certain information required by Form N-2 using Inline XBRL.

Seasoned funds are affected funds that are current and timely in their reporting and therefore generally eligible to file a short-form registration statement if they have at least \$75 million in “public float.” Under the Adopted Rules, a seasoned fund would be:

- Permitted to backward and forward incorporate<sup>10</sup> by reference;
- Permitted to omit certain information from its prospectuses at effectiveness;
- Permitted not to furnish, on request, certain engineering, management, or similar reports or memoranda relating to broad aspects of the business, operations, or products of the registrant under amended rule 418(a)(3);
- Permitted to use certain forms even if it fails to make a public disclosure required solely by rule 100 of Regulation FD;
- Permitted to incorporate by reference to provide information that otherwise must be furnished with certain types of proxy statements;
- Required to include information about an investor’s costs and expenses in the registrant’s annual report;
- Required to provide information about the share price of its stock and any premium or discount in the registrant’s annual report;
- Required to provide information about each of a fund’s classes of senior securities in the registrant’s annual report; and
- Required to disclose outstanding material<sup>11</sup> unresolved staff comments that remain unresolved for a substantial period of time.

WKSI are seasoned funds that generally have at least \$700 million in “public float.” Under the Adopted Rules, a WKSI’s registration statement would become effective immediately upon filing with the Commission and written communications would be allowed by or on behalf of WKSI at any time, including use at any time of a free writing prospectus (before or after a registration statement is filed).

The final rule amendments deviate from the March 2019 proposed rule amendments significantly in two ways. First, the final rule amendment does not include Form 8-K requirements mandating that affected funds provide a current report in the event of a material change in a fund’s investment strategy or after a material write-down of a significant investment. Second, the proposed rule amendments originally extended automatic effectiveness only to certain routine updates to registration statements. The Adopted Rules however, expand the applicability of automatic or



immediate effectiveness to continuously-offered tender offer funds. Thus, the Adopted Rules would allow continuously offered tender offer funds to make certain filings that are immediately effective upon filing or automatically effective 60 days after filing.

The Adopted Rules will become effective on August 1, 2020 except that the amendments to rules 23c-3, 24f-2, and Form 24F-2 under the 1940 Act and the amendments to rules 456 and 457 and Forms S-1, S-3, F-1 and F-3 under the 1933 Act will become effective August 1, 2021.

## SEC Grants Exemptive Relief to BDCs Due to COVID-19

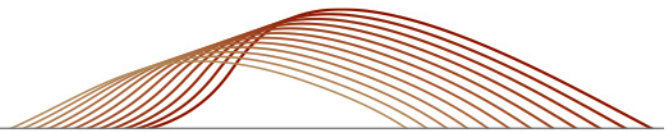
On April 8, 2020, SEC's Division of Investment Management issued Exemptive Relief (the "Order") designed to provide relief to BDCs from certain statutory requirements under the 1940 Act.

After considering the far-reaching consequences that COVID-19 has had on financial markets including BDCs and companies in which BDCs invest, the Division of Investment Management issued the Order allowing BDCs exemptions from certain requirements of the 1940 Act. The temporary exemptions provide BDCs additional flexibility with respect to (1) the issuance and sale of senior securities and (2) the participation in certain joint transactions.

With respect to issuing or selling a senior security that represents indebtedness or a stock (together, the "Covered Securities"), the Order provides that at the time of any issuance or sale of a covered senior security, the BDC shall calculate asset coverage ratios in accordance with section 18(b) of the 1940 Act, except that, in reliance on this Order, with respect to portfolio company holdings (i) that the BDC held at December 31, 2019, (ii) that the BDC continues to hold at the time of such issuance or sale, and (iii) for which the BDC is not recognizing a realized loss,<sup>12</sup> the BDC may use values calculated as of December 31, 2019, to calculate portfolio value (the "Adjusted Portfolio Value") to meet an Adjusted Asset Coverage Ratio. To calculate the Adjusted Asset Coverage Ratio, a BDC must reduce its asset coverage ratio using the Adjusted Portfolio Value by an amount equal to 25% of the difference between the asset coverage ratio calculated using the Adjusted Portfolio Value and the asset coverage ratio calculated in accordance with section 18(b) of the 1940 Act. By way of example, the Order provides that a BDC that had a 220% asset coverage ratio on December 31, 2019 but its asset coverage ratio declined to 160% as of March 31, 2020, not using the Adjusted Portfolio Value, and 200% if it calculated the ratio (without the 25% decrease) using the Adjusted Portfolio Value, the BDC would have an Adjusted Asset Coverage Ratio of 190% (200% minus 10% (25% of the difference between 200% and 160%)).<sup>13</sup>

In order to rely on the Order, a BDC must meet the following conditions:

1. **Filing Requirements.** BDC must file a Form 8-K indicating its election to rely on the Order.
2. **New Investments.** A BDC that has elected to rely on the Order shall not, for 90 days from the date of such election, make an initial investment in any portfolio company in which the BDC was not already invested as of the date of this Order, provided that a BDC may make an initial investment in such a portfolio company if at the time of investment its asset coverage ratio complies with the asset coverage ratio applicable to it under section 18 of the 1940 Act, as modified by section 61.<sup>14</sup>
3. **Board Approval.** Prior to the election to rely on the Order, a BDC must receive board approval to rely on the Commission's Order and a board determination that the issuance or sale of Covered Securities is in the best interest of the BDC and its shareholders.<sup>15</sup>



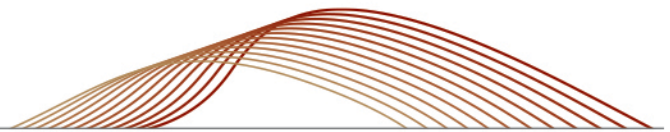
4. **Sunset Period.** After electing to take this exemption, a BDC shall receive and review reports prepared by its investment adviser assessing progress toward achieving compliance with the asset coverage requirement under section 18 of the 1940 Act. BDCs that are unable to meet the asset coverage requirement by the expiration of the exemption period will need to file a Form 8-K, including: (i) the BDC's current asset coverage ratio; (ii) the reason for non-compliance; (iii) when the BDC expects compliance; and (iv) what steps the BDC will take toward compliance.<sup>16</sup>
5. **Record Keeping.** BDCs electing to take the exemption and issue securities must preserve Board minutes discussing the issuance of Covered Securities for at least six years and any reports that the Board relied upon covering issuance of Covered Securities through this exemption.<sup>17</sup>
6. **Fees.** Except (i) to the extent permitted by 57(k) of the 1940 Act; or (ii) for payments or distributions made by an issuer to all holders of a security in accordance with the security's terms, no affiliated person of a BDC nor any affiliated person of such a person, shall receive any transaction fees (including break-up, structuring, monitoring or commitment fees) or other remuneration from an issuer in which the BDC invests during the exemption period.<sup>18</sup>

It should be noted that the relief under the Order only applies when a BDC is issuing Covered Securities and does not provide asset coverage relief to a BDC with existing senior securities but that is not issuing additional senior securities.

In addition, the Order provides that any BDC that already has a currently applicable order permitting Co-Investment Transactions ("Existing Co-Investment Order") in portfolio companies may now participate in a Follow-On Investment (which may include a Non-Negotiated Follow-On Investment) with one or more Regulated Funds and/or Affiliated Funds, provided that (i) if such participant is a Regulated Fund, it has previously participated in a Co-Investment Transaction with the BDC with respect to the issuer, and (ii) if such participant is an Affiliated Fund, it either (X) has previously participated in a Co-Investment Transaction with the BDC with respect to the issuer, or (Y) is not invested in the issuer.<sup>19</sup> These capitalized terms from the Order have the same meanings as the same or similar terms in Existing Co-Investment Orders.

When relying on the Order, a BDC must ensure that (i) the transaction is structured and effected in accordance with an Existing Co-Investment Order, and (ii) Non-Negotiated Follow-On Investments do not require prior approval by the Board; however they are subject to the periodic reporting requirements set forth in the BDC's Existing Co-Investment Order.<sup>20</sup> In connection with making the findings required by the BDC's Existing Co-Investment Order with respect to Follow-On Investments that are not Non-Negotiated Follow-On Investments, the Board, and its required majority, shall review the proposed Follow-On Investment both on a stand-alone basis and in relation to the total economic exposure of the BDC to the issuer.<sup>21</sup> The extent to which this part of the Order is useful to a BDC will depend on the conditions of that BDC's Existing Co-Investment Order.

The exemptions above go into effect immediately and will last until the earlier of December 31, 2020, or the date by which the BDC ceases to rely on the Order. The Commission noted that this exemption period may be extended, and other exemptions may be considered, as the situation around COVID-19 develops.



*If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:*

## Los Angeles

Yousuf I. Dhamee  
1.213.683.6179  
[yousufdhamee@paulhastings.com](mailto:yousufdhamee@paulhastings.com)

Arthur L. Zwickel  
1.213.683.6161  
[artzwickel@paulhastings.com](mailto:artzwickel@paulhastings.com)

## New York

Michael R. Rosella  
1.212.318.6800  
[mikerosella@paulhastings.com](mailto:mikerosella@paulhastings.com)

Ira Kustin  
1.212.318.6094  
[irakustin@paulhastings.com](mailto:irakustin@paulhastings.com)

Vadim Avdeychik  
1.212.318.6054  
[vadimavdeychik@paulhastings.com](mailto:vadimavdeychik@paulhastings.com)

Ryan S. Johnson  
1.212.318.6736  
[ryanjohnson@paulhastings.com](mailto:ryanjohnson@paulhastings.com)

## San Francisco

David A. Hearth  
1.415.856.7007  
[davidhearth@paulhastings.com](mailto:davidhearth@paulhastings.com)

- 
- <sup>1</sup> Securities Offering Reform for Closed-End Investment Companies (Final Rule) (the “Adopted Rules”), SEC Release Nos. 33-10771; 34-88606; IC-33826, available at <https://www.sec.gov/rules/final/2020/33-10771.pdf> (April 8, 2020).
- <sup>2</sup> Order under Sections 6(c), 17(d), 38(a), and 57(i) of the Investment Management Company Act of 1940 and Rule 17d-1 thereunder granting exemptions from specified provisions of the Investment Company Act and certain rules thereunder (the “Exemptive Order”), SEC Release No. 33837, <https://www.sec.gov/rules/exorders/2020/ic-33837.pdf> (April 8, 2020).
- <sup>3</sup> See Section 803(b) of Small Business Credit Availability Act, Pub. L. No. 115–141, 132 Stat. 348 (2018); See also Section 509(a) of Economic Growth, Regulatory Relief, and Consumer Protection Act, Pub. L. No. 115–174, 132 Stat. 1296 (2018).
- <sup>4</sup> Adopted Rules, at 11 n.18.
- <sup>5</sup> *Id.*, at 90.
- <sup>6</sup> *Id.* at 55.
- <sup>7</sup> Amended Rule 486(a), (b)(1)(vi), and (g).
- <sup>8</sup> Adopted Rules, at 59.
- <sup>9</sup> *Id.* at 17.
- <sup>10</sup> *Id.* at 20.
- <sup>11</sup> Although voting to approve the Adopted Rules, Commissioner Peirce noted that this requirement is unnecessarily burdensome and not optimal for investors. See Statement on Securities Offering Reform for Closed-End Investment Companies, Statement of Commissioner Hester M. Peirce (Apr. 8, 2020), <https://www.sec.gov/news/public-statement/peirce-statement-securities-offering-reform-closed-end-investment-companies>.
- <sup>12</sup> Exemptive Order, at 4.
- <sup>13</sup> *Id.*
- <sup>14</sup> *Id.* at 5.
- <sup>15</sup> *Id.* at 5-6.
- <sup>16</sup> *Id.* at 6-7.
- <sup>17</sup> *Id.* at 7.
- <sup>18</sup> *Id.*
- <sup>19</sup> *Id.* at 8.
- <sup>20</sup> *Id.* at 8-9.

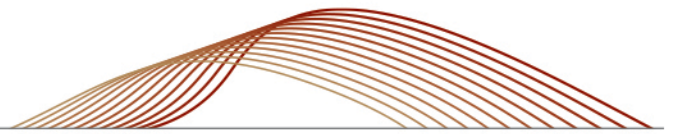
## Paul Hastings LLP

Stay Current is published solely for the interests of friends and clients of Paul Hastings LLP and should in no way be relied upon or construed as legal advice. The views expressed in this publication reflect those of the authors and not necessarily the views of Paul Hastings. For specific information on recent developments or particular factual situations, the opinion of legal counsel should be sought. These materials may be considered ATTORNEY ADVERTISING in some jurisdictions.



# STAY CURRENT

---



---

<sup>21</sup> *Id.* at 9.