

**MEMO# 32380**

April 9, 2020

# SEC Provides Temporary Flexibility to Business Development Companies to Provide Capital to Portfolio Companies

[32380]

April 9, 2020 TO: ICI Members SUBJECTS: Closed-End Funds  
Compliance RE: SEC Provides Temporary Flexibility to Business Development Companies to Provide Capital to Portfolio Companies

On April 8, the Securities and Exchange Commission provided temporary exemptive relief<sup>[1]</sup> to business development companies (“BDCs”) to more flexibly issue and sell senior securities (e.g., make loans) to underlying portfolio companies, including businesses affected by the coronavirus pandemic.<sup>[2]</sup> The relief is intended to allow BDCs to continue to provide capital to small- and mid-sized businesses in light of the current market environment. It covers BDCs that otherwise would be restricted from issuing and selling senior securities because:

- the BDCs could not meet regulatory asset coverage requirements due to temporary markdowns in the value of loans to portfolio companies; or
- the BDCs’ affiliates could not participate in additional investments in the portfolio companies due to restrictions in a BDC’s exemptive order permitting co-investments (“co-investment orders”).

The temporary relief expires the earlier of December 31, 2020 or the date on which a BDC ceases to rely on the exemptive relief (“Exemptive Period”). The relief is subject to the conditions set forth below:

## I. Relief from Asset Coverage Requirements

Notwithstanding asset coverage requirements<sup>[3]</sup> and the values the Investment Company Act prescribes to determine such asset coverage requirements,<sup>[4]</sup> a BDC could issue or sell a senior security that represents indebtedness or that is a stock (“covered senior security”), provided that:

(a) *Adjusted Portfolio Value.* At the time of issuance or sale of a covered senior security, the fund will calculate asset coverage ratios consistent with the Investment Company Act, except for portfolio company holdings that (i) the BDC held on December 31, 2019, (ii) that the BDC continues to hold at the time of such issuance or sale, and (iii) for which it has not

recognized a realized loss.<sup>[5]</sup> For those holdings, 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.”<sup>[6]</sup>

(b) *Election.* A BDC must elect to rely on, or withdraw its election to rely on, the exemptive relief by filing a Form 8-K.

(c) *Limitation on New Investments.* A BDC shall not, for 90 days from the date of election, make an initial investment in any portfolio company in which it was not already invested as of the date of the exemptive relief (April 8), unless it complies with the asset coverage requirements under the Investment Company Act.

(d) *Board Approval of Reliance on the Order.* Prior to the BDC’s election to rely on the relief, the BDC’s board of directors (“Board”), including a majority of the Board required under Section 57(o) of the Investment Company Act (“Required Majority”), shall determine that the issuance or sale of covered senior securities pursuant to the exemptive relief is permitted and is in the best interest of shareholders.

(e) *Board Approval of Each Issuance of Senior Securities.* Prior to a BDC issuing or selling covered senior securities, the Board, including a Required Majority, shall determine that each such issuance is in the best interests of the BDC and its shareholders.<sup>[7]</sup>

(f) *No Sunset Period.* The Board shall receive and review, at least monthly, reports prepared by the BDC’s investment adviser regarding and assessing the efforts that the investment adviser has undertaken, and progress that the BDC has made, towards complying with the asset coverage requirements under the Investment Company Act by the end of the Exemptive Period. Any BDC not in compliance with the asset coverage requirements under the Investment Company Act by the end of the Exemptive Period shall immediately make a filing on Form 8-K that includes information about compliance.<sup>[8]</sup>

(g) *Recordkeeping.* Each BDC shall make and preserve, for a period of not less than six years, the first two years in an easily accessible place, records related to the relief.<sup>[9]</sup>

(h) *No Compensation or Remuneration of Any Kind.* Except (i) to the extent permitted for acting as a broker or agent under Section 57(k) of the Investment Company Act; or (ii) for payments or distributions made to all securityholders in accordance with a security’s terms, no affiliated person of the 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 Exemptive Period.<sup>[10]</sup>

## **II. Relief for BDCs with Existing Co-Investment Orders**

Notwithstanding certain of the affiliated transaction prohibitions under the Investment Company Act,<sup>[11]</sup> a BDC that has received a co-investment order may participate in a Follow-On Investment with one or more Regulated Funds and/or Affiliated Funds, provided that:<sup>[12]</sup>

(a) Any such transaction is otherwise effected in accordance with the terms and conditions of the existing co-investment order; and

(b) *Board Oversight.*

(1) *Non-Negotiated Follow-On Investments.*<sup>[13]</sup> Non-Negotiated Follow-On Investments are subject to the periodic reporting requirements set forth in the BDC’s existing co-investment

order.

(2) *Follow-On Investments other than Non-Negotiated Follow-On Investments.* 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 a 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.

Kenneth Fang  
Assistant General Counsel

#### endnotes

[1] The press release announcing the relief is available at <https://www.sec.gov/news/press-release/2020-84>. The press release also includes links to the order granting relief, which can be accessed directly at <https://www.sec.gov/rules/exorders/2020/ic-33837.pdf>.

[2] A "senior security" means any bond, debenture, note, or similar obligation or instrument constituting a security and evidencing indebtedness, and any stock of a class having priority over any other class as to distribution of assets or payments of dividends. See Section 18(g) of the Investment Company Act of 1940.

[3] See Sections 18(a)(1)(A) and 18(a)(2)(A) of the Investment Company Act, as modified for BDCs by Sections 61(a)(1) and 61(a)(2) of the Investment Company Act (setting forth minimum asset coverage requirements for BDCs issuing debt and preferred shares).

[4] See Section 18(b) of the Investment Company Act (requiring funds to determine asset coverage amounts based on values calculated within 48 hours (not including Sundays or holidays) of such determination).

[5] BDCs may not include a December 31, 2019 fair value measurement in their "Adjusted Asset Coverage Ratio," if the portfolio company holding is permanently impaired. A permanently impaired holding is a holding where a BDC recognized a realized loss subsequent to December 31, 2019, and the loss is not recoverable.

[6] 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 percent of the difference between the asset coverage ratio calculated using the Adjusted Portfolio Value and the asset coverage ratio normally calculated under the Investment Company Act. The Commission provides an example of this calculation for a BDC with a 220 percent asset coverage ratio on December 31, 2019. Suppose its asset coverage ratio declines to 160 percent on March 31, 2020, not using the Adjusted Portfolio Value, and 200 percent if it calculated the ratio (without the 25 percent decrease) using the Adjusted Portfolio Value. The BDC then would have an Adjusted Asset Coverage Ratio of 190 percent (200 percent minus 10 percent (25 percent of the difference between 200 percent and 160 percent)).

[7] Prior to such determination, the Board must obtain and consider (i) a certification from

the BDC's investment adviser that the issuance of covered senior securities is in the best interests of the BDC and its shareholders; such certification shall include the investment adviser's recommendation and the reasons therefore, including whether the adviser has considered other reasonable alternatives that would not result in the issuance or sale of a covered senior security; and (ii) advice from an independent evaluator regarding whether the terms and conditions of the proposed issuance or sale of a covered senior security are fair and reasonable compared to similar issuances, if any, by unaffiliated third parties in light of current market conditions.

[8] The Form 8-K must include: (i) the BDC's current asset coverage ratio; (ii) the reasons why the BDC could not comply with the asset coverage requirements; (iii) when the BDC expects to come into compliance with the asset coverage requirements; and (iv) the specific steps the BDC will take to bring itself into compliance with the asset coverage requirements.

[9] These include minutes describing (i) the Board's deliberations in connection with paragraph (e) above, including the factors considered with such determinations, as well as all information, documents and reports provided to the Board in connection therewith; and (ii) the reports made to the Board pursuant to paragraph (f) above, including copies of all other information provided to or that the Board relied on.

[10] The condition does not apply to investment advisory fees.

[11] See Sections 17(d) and 57(a)(4) under the Investment Company Act and Rule 17d-1 thereunder (restricting certain types of joint affiliated transactions).

[12] Regulated Funds must have previously participated in a Co-Investment Transaction with the BDC with respect to the issuer. Affiliated Funds either (a) must have previously participated in a Co-Investment Transaction with the BDC with respect to the issuer; or (b) must not be invested in the issuer. The terms "Follow-On Investment," "Regulated Fund," "Affiliated Fund," and "Co-Investment Transaction" have the same meanings ascribed to them in the BDC's co-investment order. For purposes of the exemptive relief, the term "Affiliated Fund" does not include any open-or closed-end fund registered under the Investment Company Act or BDC.

[13] The term "Non-Negotiated Follow-On Investment" shall have the meaning ascribed to it in existing co-investment orders. For purpose of the exemptive relief, a BDC may participate in a Non-Negotiated Follow-On Investment in reliance on this exemptive relief whether or not such term is used in its existing co-investment order.