To Our Clients and Friends

Memorandum

Pending Legislation Would Ease Leverage Limits and Improve the Securities Offering Process for Business Development Companies

On January 18, 2018, Senators Heller and Manchin introduced the Small Business Credit Availability Act in the U.S. Senate, a bipartisan bill that would loosen current restrictions on the capital structure of business development companies (BDCs) and improve the securities offering process for BDCs under the Securities Act of 1933 (1933 Act). BDCs are significant financing sources for small and middle market companies, and their significance has been increasing in recent periods.

Specifically, the bill would amend the Investment Company Act of 1940 to reduce the asset coverage ratio applicable to BDCs (i.e., total assets to total debt) from 200% to 150%, subject to the approval of such change by (1) more than 50% of the shareholders or (2) a majority of the disinterested directors and a majority of directors who have no financial interest in the BDC. In the case of non-listed BDCs, the BDC must also offer to repurchase all of its shares. By easing this ratio, BDCs could increase their leverage and deploy more capital, thereby potentially increasing overall returns. BDCs considering this change would also need to review debt incurrence and financial ratio covenants set out in existing debt instruments.

In addition, the bill would direct the SEC to improve the securities offering process for BDCs under the 1933 Act by providing BDCs with certain benefits presently available to traditional operating companies. First, the SEC would expand its definition of "well-known seasoned issuer," also known as a WKSI, to include BDCs, which would allow BDCs to file automatically effective shelf registration statements. Second, BDCs would be able to take advantage of certain communications rules under the 1933 Act, thereby improving the securities offering process for BDCs. Third, BDCs that meet the requirements of a Form S-3 registration statement would be permitted to incorporate by reference their annual, quarterly and periodic reports filed with the SEC into the Form N-2 registration statement used by BDCs, thereby allowing automatic updating of their Form N-2 registration statements, which would ease the burdens on BDCs in issuing public equity.

The bill is currently under review by the Senate Committee on Banking, Housing, and Urban Affairs, after which it may be sent to the full Senate for consideration, followed by formal votes in the Senate and the U.S. House of Representatives. The U.S. House Financial Services Committee voted 58-2 to adopt a similar bill in November 2017.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its contents. If you have any questions about the contents of this memorandum, please call your regular Fried Frank contact or an attorney listed below:

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