To Our Clients and Friends

Memorandum

New Law Will Benefit BDCs by Easing Leverage Limits and Improving the Securities Offering Process

On March 23, 2018, President Trump signed into law the Small Business Credit Availability Act (SBCAA) as part of an omnibus spending bill.[1] The SBCAA will significantly impact the current practices of business development companies (BDCs) by: (1) easing the current asset coverage ratio requirements for BDCs to issue senior securities or pay cash dividends under the Investment Company Act of 1940 (1940 Act), and (2) improving the securities offering process for BDCs under the Securities Act of 1933 (1933 Act) by providing certain benefits that were previously only available to non-BDC issuers.[2] BDCs are significant financing sources for small and middle market companies, and their significance has been increasing in recent periods.

Easing the Asset Coverage Ratio Requirements for BDCs

Under the 1940 Act, BDCs may not issue any class of senior security or pay any cash dividend unless the BDC has asset coverage of at least 200% immediately after the issuance or dividend. The SBCAA amends Section 61(a) of the 1940 Act to reduce the asset coverage ratio requirements applicable to BDCs from 200% to 150%. In other words, the SBCAA allows BDCs to increase their debt-to-equity ratio from 1:1 to 2:1. However, such reduction in the asset coverage ratio requirements must first be approved by either (1) a majority of the shareholders or (2) a majority of the disinterested directors and a majority of directors who have no financial interest in the BDC, and such approval must be publicly disclosed. In addition, a non-listed BDC which obtains such approval must offer to repurchase all of its currently outstanding shares over a 12 month period. By easing this ratio, BDCs can increase their leverage and deploy more capital, thereby potentially increasing overall returns. BDCs considering this change will also need to review debt incurrence and financial ratio covenants set out in existing debt instruments.

Pursuant to the SBCAA, the amendment to Section 61(a) of the 1940 Act became effective on March 23, 2018.

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1 The full text of the omnibus spending bill (formally known as the Consolidated Appropriations Act, 2018), which includes the text of the SBCAA on pages 1999 through 2010, is available at: http://docs.house.gov/billsthisweek/20180319/BILLS-115SAHR1625-RCP115-66.pdf.

2 See our client memorandum dated February 16, 2018 for a discussion of the Senate version of the SBCAA which was similar to the version signed into law by President Trump (http://www.friedfrank.com/siteFiles/Publications/FINAL_021218PendingLegislationSBCAA.pdf).

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Improving the Securities Offering Process for BDCs

The SBCAA also requires the Securities and Exchange Commission (SEC) to make changes to certain of its rules and forms so that BDCs may utilize a registration and reporting framework which was previously only available to traditional operating companies. The SBCAA refers to this change as "parity" for BDCs and includes the following notable changes:

- A BDC may now qualify as a "well-known seasoned issuer," or WKSI, and file automatically effective shelf registration statements (i.e., no review by the staff of the SEC), have reduced disclosure requirements in its shelf registration statements, and utilize a "pay as you go" filing fee system. In additions, BDCs which are WKSIs will have the benefit of more liberal communications rules under the 1933 Act.
- BDCs will be permitted to incorporate by reference their periodic reports filed with the SEC pursuant to the Securities Exchange Act of 1934 (1934 Act) into a shelf registration statement on Form N-2. This change permits automatic updating of a BDC's shelf registration statement for new financial information rather than annual updating through a post-effective amendment or the filing of a new shelf registration statement each year.

These amendments should result in cost savings for BDCs in the offering and registration process, as well as reduce the time requirements of company management. In addition, BDCs should be able to more efficiently access the capital markets and take advantage of offering windows on a timelier basis.

Pursuant to the SBCAA, the SEC is required to make the specified revisions to its rules and forms within one year after the enactment of the SBCAA. If the SEC fails to timely complete the required revisions, during the period beginning the first day after the first anniversary of the enactment of the SBCAA and ending on the date the SEC completes the revisions, BDCs may deem the revisions to have been completed.

Summary of the SBCAA Provisions

The following chart summarizes the relevant law, rules and forms that the SBCAA impacts and the related change for BDCs.

Topic	Effect of SBCAA on BDCs
Section 802 of SBCAA (immediately effective on March 23, 2018)	
Asset Coverage Ratio *(Section 61(a) of 1940 Act)*	▪ Reduces the asset coverage ratio applicable to BDCs from 200% to 150%. ▪ The reduction must be approved by either (a) more than 50% of shareholders of the BDC at a shareholder meeting (which approval becomes effective on the first day after the date of the approval) or (b) a majority of the disinterested directors and a majority of directors who have no financial interest in the BDC (which approval becomes effective on the date that is one year after the date of the approval), and publicly disclose such approval within five business days of such approval in its periodic reports under the 1934 Act and on its website as well make certain required

Topic	Effect of SBCAA on BDCs
	disclosures in its periodic reports under the 1934 Act. ▪ For non-listed BDCs which obtain such approval, the BDC must also offer to repurchase all currently outstanding shares of the BDC with 25% of the shares to be repurchased in each of the four quarters following the calendar quarter in which the approval date takes place.
Section 803 of SBCAA (SEC required to make revisions not later than 1 year after the enactment of SBCAA)	
WKSI Status (Rules 405, 433 and 164 under the 1933 Act)	▪ Allows BDCs to qualify as WKSIs and thereby file automatically effective shelf registration statements with flexibility on the disclosure required in such registration statements, use free writing prospectuses, and defer filing fees until securities are offered to the market (known as "pay as you go").
Incorporation by Reference (Form N-2 and Rule 415 under the 1933 Act)	▪ Permits eligible BDCs to incorporate by reference their periodic reports filed under the 1934 Act into their registration statements on Form N-2.
Final Prospectus (Rule 497 under the 1933 Act)	▪ Conforms the process for filing prospectuses under Rule 497 to the process of non-BDC registrants under Rule 424(b) of the 1933 Act.
Prospectus Delivery (Rules 172 and 173 under the 1933 Act)	▪ Permits "access equals delivery" for delivery of a final prospectus for BDCs by filing with the SEC, as is currently available for non-BDC issuers.
Offering Communications (Rules 134, 163 and 163A under the 1933 Act)	▪ Provides safe harbors to BDCs for certain communications around the time of a securities offering, including those made more than 30 days prior to filing a registration statement (or at other times for WKSIs) if certain conditions are met, to the same extent as non-BDC issuers.
Release of Business Information (Rules 168, 169 and 156 under the 1933 Act)	▪ Provides exemptions to BDCs for communications of regularly released factual business information and forward-looking information to the same extent as non-BDC issuers.
Research Reports (Rules 138 and 139 under 1933 Act)	▪ Permits broker-dealers to publish research reports about a BDC and its securities (including for broker-dealers participating in a distribution of securities), to the same extent, and subject to the same limitations, as broker-dealers publishing research reports about non-BDC issuers and their securities.
Proxy Statements (Schedule 14A and Rule 14a-101 under the1934 Act)	▪ Permits BDCs to incorporate by reference previously filed information to the same extent as non-BDC issuers.
Regulation FD (Rule 103 of Regulation FD)	▪ Provides that a failure of a BDC to make filings pursuant to Regulation FD does not affect whether a BDC has filed all required

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	1934 Act information to be eligible to use a Form N-2 registration statement in the future, to conform to the same rule applicable to a non-BDC issuer's eligibility to use a Form S-3 registration statement.

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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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