Proskauer

SEC Proposes Expedited Exemptive Relief Process and SEC Staff Issues Guidance on Repurchase Offers by Non-Traded BDCs

October 24, 2019

The Securities and Exchange Commission (the "Commission") and the staff of its Division of Investment Management (the "Staff") have recently taken two actions that may prove beneficial to registered funds and business development companies ("BDCs"). First, the Commission proposed rule amendments (the "Proposed Amendments") to the exemptive relief application process under the Investment Company Act of 1940, as amended (the "1940 Act"), which, in part, would establish expedited review procedures for applications that are substantially identical to recent precedent.[1] Second, in response to inquiries from the BDC industry, the Staff released guidance (the "Repurchase Guidance") applicable to the required repurchase offers by non-traded BDCs seeking to reduce their asset coverage requirement from 200% to 150% in accordance with Section 61 of the 1940 Act.[2]

Proposed Amendments to Exemptive Relief Application Process

Rule 0-5 under the 1940 Act prescribes the process for registered funds and BDCs to apply for an order from the Commission for exemptive or other relief under the 1940 Act. Such exemptive orders historically have been required for certain funds to operate (e.g., exchange-traded funds or interval funds that seek to offer multiple share classes similar to an open-end fund operating in accordance with Rule 18f-3 under the 1940 Act) and to permit certain activities and transactions that would otherwise be prohibited by the 1940 Act (e.g., interfund lending arrangements or the ability of registered funds and BDCs to participate in certain negotiated co-investment transactions). The Proposed Amendments principally would amend Rule 0-5 to establish an expedited review procedure for qualifying applications and create a timeframe for standard review applications that do not qualify for the new expedited review process.

Expedited review would be available for an exemptive relief application that is "substantially identical" to two other applications for which an order granting the requested relief has been issued by the Commission within two years of the date of the application's initial filing. Proposed Rule 0-5(d)(2) defines "substantially identical" applications as applications that request relief from the same sections of the 1940 Act and rules thereunder, contain identical terms and conditions and differ only with respect to factual differences that are not material to the relief requested.[3]

Applicants would not be permitted to "mix and match" precedent relief for submission under the expedited review process, and applications that combine portions or sections of prior different applications would need to be submitted through the standard review process. Furthermore, applications that are highly fact-specific or include different terms and conditions than those of precedent applications, including applications to participate in certain negotiated co-investments, generally would not meet the proposed substantially identical standard and therefore would not qualify for expedited review.[4]

Under the expedited review process, the Commission would have 45 days from the date of filing of an application to either (i) notice the application or (ii) notify the applicant that (a) the application is ineligible for expedited review or (b) additional review time is necessary.[5] If the Staff notifies the applicant that its application is not eligible for expedited review, the applicant would be asked to either withdraw the application or amend it to make changes to facilitate the application being considered under the standard review process.

Proposed Rule 0-5 also includes certain disclosure, procedural and information requirements for applications seeking expedited review, as well as rules regarding the calculation of the 45-day review period, including "pauses" in the event of amendment by the applicant or comments on the application from the Staff. Under the Proposed Amendments, failure to appropriately respond to a request for modification within 30 days of such request would result in the application being deemed withdrawn without prejudice.

For those applications that do not qualify for expedited review, the Proposed Amendments would formalize the Staff's current 90-day internal performance timeline and require the Staff to take action on all standard review applications within 90 days of the initial filing or any amendment thereto, subject to 90-day extensions at the Staff's discretion. Action may consist of noticing the application, providing requests for clarification or modification of the application or forwarding the application to the Commission for consideration.[6] Furthermore, under the Proposed Amendments, a standard review application would be deemed to have been withdrawn without prejudice if an applicant does not respond in writing to comments within 120 days of receipt.[7]

Notably, in the Proposing Release, the Commission stated that it intended to have its Staff publicly disseminate comments and responses on all exemptive relief applications no later than 120 days after the final disposition of such application (regardless of whether the application was submitted under the expedited or standard review process). Applicants would, however, still be able to submit requests for confidential treatment.

The Proposed Amendments aim to improve the efficiency of the exemptive relief application process, saving applicants both time and costs, while allowing the Staff to devote more time to review non-routine applications as needed. However, the benefits of the Proposed Amendments are unclear at this time. For example, due to the high bar of the proposed substantially identical standard, we expect that applicants will need to weigh the appeal of seeking faster (and more certain) exemptive relief through the expedited process against what may otherwise be a preference to seek modified (and less certain) relief through the standard review process. Moreover, the proposed timeline for standard review formalizes an already existing internal Staff review timeline and expressly constitutes informal non-binding guidelines and procedures that the Commission anticipates the Staff to follow. Thus, under both expedited and standard review processes, the Staff would continue to have broad discretion to extend the applicable review period, and there are no apparent consequences for failure to meet the associated deadlines.

Repurchase Guidance for BDCs

Section 61(a) of 1940 Act permits a BDC to reduce its asset coverage requirements for senior securities from 200% to 150%, subject to certain conditions and procedural requirements. In particular, a BDC that does not have its common equity listed on a national securities exchange (i.e., a non-traded BDC) is required to offer each investor of record as of the date on which 150% asset coverage is approved the opportunity for the BDC to repurchase such investor's securities held on such date, with 25% of each accepting investor's securities to be repurchased in each of the four calendar quarters following the date of approval.

In issuing the Repurchase Guidance, the Staff stated its belief that a non-traded BDC may satisfy these repurchase obligations by providing either (i) one offer to repurchase all of the common equity held by all investors of the BDC or (ii) four separate quarterly repurchase offers. In each case, repurchases should be effected quarterly at the BDC's net asset value at the time of each repurchase (as opposed to the net asset value at the time of the offer).

The Staff also advised that it would not recommend enforcement action under Section 61(a) if a non-traded BDC elects to effect the required repurchases more quickly than over four successive quarters. However, the Staff noted that any BDC considering accelerated repurchases should (i) evaluate the consequences of the action on any remaining investors (e.g., the potential for dilution and any effects on portfolio management) and (ii) disclose, in conjunction with the repurchase offer, its anticipated schedule for effecting the repurchases as the timing of liquidity may be material to an investor's decision whether to accept the offer.

The Staff also stated its belief that the required repurchases need not be conducted as an offer under Section 23(c) of the 1940 Act or Sections 13(e) and 14(e) of the Securities Exchange Act of 1934, as amended (the "1934 Act"), and the rules thereunder (the "Repurchase and Tender Rules"), to the extent that the Repurchase and Tender Rules are inconsistent with Section 61. However, the Staff noted that the Repurchase and Tender Rules provide useful guidance and processes for the repurchase process under Section 61(a) and that a BDC may choose to use the forms, communications and filing processes under those rules.[8] Moreover, the Staff encouraged non-traded BDCs to follow Commission filing requirements under, for example, Section 13(e) under the 1934 Act, and the rules thereunder, and provide related documents to investors.

Finally, the Staff noted its view that the repurchase obligations are triggered at the time the requisite approval for 150% asset coverage is received and constitute an obligation to make an offer to specific investors. Therefore, a non-traded BDC that receives the requisite approval and subsequently lists its common equity on a national securities exchange is not relieved from its repurchase obligations, and the right of an investor to receive a repurchase offer or to sell securities for which such an offer is made would not transfer with transfers of the BDC's securities.

The Repurchase Guidance provides non-traded BDCs with greater certainty in complying with the requirements of Section 61(a), as well as incremental flexibility in satisfying the repurchase offer obligations. However, the benefits of the Repurchase Guidance are anticipated to be somewhat limited as non-traded BDCs commencing operations since the March 2018 passage of the Small Business Credit Availability Act typically have received approval of 150% asset coverage from a single seed investor making a de minimis investment prior to the admission of outside investors.

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[1] The Proposed Amendments are available at https://www.sec.gov/rules/proposed/2019/ic-33658.pdf (the "Proposing Release"). The Proposed Amendments will have a 30-day comment period following the publication of the Proposing Release in the Federal Register, which has not yet occurred as of the date of this Client Alert. The Proposed Amendments would not affect applications submitted to the Commission under the Investment Advisers Act of 1940, as amended.

[2] The Repurchase Guidance is available at https://www.sec.gov/investment/staff-responses-regarding-business-development-companies.

[3] Factual differences not material to the relief requested may include the applicants' identities, the jurisdiction of organization of a fund or the constitution of the fund's board of directors/trustees. See Proposing Release at 13.

[4] Although it solicited comment on this point, the Commission cited other kinds of applications that it believed were unlikely to be suitable for expedited review, including applications filed under Section 2(a)(9) (determinations of control), Section 3(b)(2) (inadvertent investment companies), Section 6(b) (employee securities companies), Section 9(c) (disqualification/ineligibility) and Section 26(c) (substitution of securities by unit investment trusts). Proposing Release at 14-15 and n. 32.

[5] The Commission has granted the Director of the Division of Investment Management delegated authority to issue notices of applications and orders generally where the matter does not appear to the Director to present significant issues that have not been previously settled by the Commission or to raise questions of fact or policy indicating that the public interest or the interest of investors warrants the Commission consider the matter. Consistent with this delegated authority, the Staff would issue notices for applications reviewed under the proposed expedited review process.

[6] If forwarded to the Commission, the Commission would not be subject to the 90-day timeline provided by the new rule. Proposing Release at 21.

[7] Applicants also could request to withdraw applications with a letter filed as Form APP-WD through the Commission's EDGAR system.

[8] The Repurchase Guidance further advised that a non-traded BDC considering whether to use forms, communications and filing processes other than those prescribed by the Repurchase and Tender Rules should consider discussing the matter with the staff of the Chief Counsel's Office.