

October 31, 2019

Staff Responds to Questions About Non-Traded BDCs and Section 61(a) of the 1940 Act

On October 17, 2019, the SEC's Division of Investment Management published *Staff Responses to Inquiries Regarding Business Development Companies and Section 61(a) of the Investment Company Act of 1940* (the "Publication") concerning compliance by business development companies (each, a "BDC") whose common shares are not exchange listed (a "non-traded BDC") with the repurchase-offer requirements within recently amended Section 61(a).

Background. As described in an earlier Ropes & Gray [Investment Management Update](#), the Small Business Credit Availability Act, enacted in March 2018, amended Section 61(a) of the 1940 Act to change the minimum asset coverage requirement for a BDC from 200% to 150% – effectively doubling the amount of leverage that a BDC may employ. Before a BDC can rely on the 150% asset coverage requirement (the "150% Minimum"), the BDC must obtain approval of its shareholders or of its board of directors. With shareholder approval, the 150% Minimum may be relied upon the day after approval but, with approval from a BDC's board of directors, the 150% Minimum may be relied upon beginning one year after the date of board approval.

Amended Section 61(a) contains an additional condition applicable to non-traded BDCs. Specifically, a non-traded BDC that seeks to rely on the 150% Minimum must offer to repurchase shares belonging to shareholders as of the date of shareholder or board approval of the 150% Minimum, with 25% of the shares to be repurchased in each of the four calendar quarters following the calendar quarter in which the approval occurred (the "Repurchase Condition").¹

The Publication. Following the amendments to Section 61(a), the SEC staff received inquiries regarding the Repurchase Condition. These inquiries and the SEC staff responses, as set forth in the Publication, are summarized below.

Q1. With its repurchase offer, may a non-traded BDC provide the following (and, if so, at what price):

- (i) a **single offer** to repurchase all the securities held by all shareholders as of the date of an approval, with the repurchase of 25% of the securities of such shareholders who accept the offer to be effected quarterly, or*
- (ii) **four separate, quarterly offers** to repurchase 25% of the securities held by all shareholders as of the date of an approval, with the repurchase of the securities of such shareholders who accept each offer to be effected in the same quarter as the offer?*

A1. The SEC staff stated that the relevant text of amended Section 61(a) can be read to permit a non-traded BDC to follow either of the approaches in (i) or (ii), with the repurchases in both cases to be made quarterly. In addition, the SEC staff stated that each repurchase price should be based on the current NAV of the non-traded BDC at the time of a repurchase, instead of the NAV at the time of the offer.

Q2. Could a non-traded BDC effect the repurchases more quickly than required by the Repurchase Condition? For example, solely for purposes of the Repurchase Condition, could a non-traded BDC extend a single offer to repurchase all securities held by shareholders as of the date of an approval and, then, repurchase 100% of the securities of shareholders who accept the offer in the first quarter rather than over four successive quarters?

A2. The SEC staff stated that the Repurchase Condition is designed to protect the interests of those shareholders who do not wish to remain invested in a non-traded BDC with a lower asset coverage, while providing the non-traded BDC

¹ The Condition is set forth in Section 61(a)(2)(D)(ii).

sufficient time to sell assets to pay for the repurchased shares. Accordingly, the SEC staff stated that it would not recommend enforcement action if a non-traded BDC were able to raise funds more quickly and effect the Repurchase Condition's repurchases more quickly, thereby allowing shareholders who accept the offer to have all their shares repurchased more quickly. However, the SEC staff stated that a non-traded BDC that intended to follow an accelerated approach would need to (i) consider the effects of the accelerated repurchases on remaining shareholders, including shareholder dilution and portfolio-management effects, and (ii) in conjunction with the repurchase offer, disclose its expected repurchase schedule because the timing of liquidity could be material to shareholders in deciding whether to accept the repurchase offer.

Q3. Does a BDC extending an offer to repurchase to satisfy the Repurchase Condition need to conduct the offer under section 23(c) of the 1940 Act or under sections 13(e) and 14(e) of the Securities Exchange Act of 1934 and the rules thereunder (the "Exchange Act provisions")?

A3. The SEC staff observed that the Repurchase Condition requires a repurchase offer to specific shareholders, and that it permits, but does not require, that the offer take the form of a tender offer. While Section 23(c) of the 1940 Act and the Exchange Act provisions provide useful guidance and processes for non-traded BDCs, the SEC staff stated that it does not believe that these provisions should be applied if doing so would be inconsistent with the text of the Repurchase Condition. Therefore, the SEC staff believes that, in extending an offer to repurchase for the exclusive purpose of complying with the Repurchase Condition, a non-traded BDC is not required to conduct the repurchase offer under Section 23(c) of the 1940 Act or under the Exchange Act provisions.

However, a non-traded BDC may, but is not required to, utilize the forms, communications and filing processes under Section 23(c) or Section 13(e) of the Exchange Act provisions that it would ordinarily use in making a repurchase offer or a tender offer. The SEC staff encourages non-traded BDCs to follow the SEC's filing requirements under, for example, Section 13(e) and the rules thereunder and to provide related documents to shareholders. Finally, the SEC staff recommended that, if a non-traded BDC is contemplating whether to employ forms, communications and filing processes different from those it would normally employ to make a repurchase offer or tender offer, the non-traded BDC should consider contacting the SEC staff.

Q4. If a non-traded BDC lists its common shares on a national securities exchange after receiving the requisite approval under Section 61(a), is it required to fulfill the Repurchase Condition and offer to repurchase all the securities held by shareholders as of the date of the approval?

A4. The SEC staff stated that it believes that the Repurchase Condition requires a BDC that was a non-traded BDC when it received an approval of the 150% Minimum under Section 61(a) still must satisfy the Repurchase Condition. The SEC staff noted that Section 61(a) does not provide an exception from the Repurchase Condition for a non-traded BDC whose common shares become listed *after* the date of an approval of the 150% Minimum. However, the SEC staff stated that it believes that the right to receive a repurchase offer or to sell securities pursuant to the Repurchase Condition would not (i) transfer with the securities of the BDC if, following listing of the BDC's shares, a shareholder sells the shares, or (ii) attach to securities that a shareholder purchases subsequent to the approval date.

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