

Everything You Need to Know About BDCs

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All About BDCs

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- Part III: Regulatory and Reporting Requirements
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Part I: History and Overview of BDCs

Overview

- Unique form of a closed end fund that:
 - Provides small, growing businesses access to capital
 - Enables private equity funds to access the public capital markets
 - Enables retail investors to participate in the upside of pre-IPO investing with enhanced liquidity
- Hybrid between an operating company and an investment company

History

- Created by the Small Business Investment Incentive Act of 1980
 - Private equity and venture capital firms believed the “small private investment company” exemption in the Investment Company Act of 1940 limited their capacity to provide financing to small, growing businesses.
 - The stated objective of the Small Business Investment Incentive Act of 1980 was to encourage the establishment of public vehicles that would invest in private companies, and thereby increase the flow of capital to small, growing businesses.
- Envisioned as publicly traded closed-end funds that would make investments in private or thinly traded companies in the form of long-term debt or equity with the goal of generating current income and capital appreciation.
- Provided Regulated Investment Company (RIC) status in 1990.

Development of the BDC Market

- Largest BDCs were primarily internally managed prior to 2003.
 - Reflected the success of the internally managed, income-producing BDC model.
- Rapid growth in the BDC industry since 2004 with a steady stream of IPOs and shift in focus to the externally managed model.
 - Approximately 9% of BDCs operating today are externally managed and nearly all newly-filed BDCs are structured to be externally managed.
- BDCs continue to access the capital markets through equity and debt offerings.

Structure

Benefits of the BDC Structure

- **ACCESS.**
 - Access to public capital markets.
 - Shares may be traded on national exchanges.
- **TAX EFFICIENT.** Flow through tax treatment as an RIC.
- **LESS RESTRICTIVE.** Reduced burdens under the 1940 Act, as compared to registered closed-end funds.
 - Restrictions on leverage.
 - Restrictions on affiliated transactions.
- **INCENTIVES FEES.** External management model permits management fee and “carried interest” incentive fee structure.
- **TRANSPARENCY.** Publicly available financial information through quarterly reporting.
- **DIVERSIFICATION.** Portfolio is diversified to comply with RIC tax requirements.
 - Reduces risks typically associated with private equity investments.

Part II: BDC Structures

BDC Structures

- Traded BDCs
 - Listed on NASDAQ or NYSE.
 - Formed either as a blind-pool vehicle or through the acquisition of an existing portfolio.
 - IPO through traditional firm commitment underwritten offering.
- Private BDCs
 - Shares not listed on an exchange.
 - Shares sold through private placement offering and funding effected through capital call model.
 - Generally intend to conduct IPO or other liquidity event typically within 3-5 years.
 - Generally no liquidity of shares prior to a qualifying IPO or other liquidity event.
- Non-Traded BDCs
 - Shares sold through continuous offerings up to preset maximum amount.
 - Liquidity offered through periodic repurchase offers.
 - Typically 5-7 year period before exchange listing or traditional IPO.

Traded BDCs

Traded BDCs: The IPO

- IPO typically completed within 6-8 months.
- Formation/structuring issues in connection with IPOs:
 - Portfolio acquisition and the management of any built-in gain
 - Form of consideration to be used in formation transaction
 - Consideration of any exemptive relief
 - Co-investment with sister funds
- Pre-IPO considerations:
 - Preparation of Form ADV for investment adviser if externally-managed
 - Development of compliance/corporate governance programs
 - Selection of service providers
 - Public accountants, valuation assistance, custodian, etc.

Traded BDCs: The IPO Process

- Form the BDC (typically formed as a Delaware or Maryland corporation).
- File an IPO registration statement on Form N-2 under the Securities Act of 1933.
 - The JOBS Act permits “emerging growth companies,” including BDCs, to confidentially file an initial registration statement, which minimizes market and reputational risks.
- Register a class of securities under the Securities Exchange Act of 1934.
- File Form N-54A to elect to be regulated as a BDC.
- Declaration of effectiveness of the Form N-2 registration statement by the SEC.
- Comply with regulatory requirements of the Investment Company Act of 1940.
- Comply with reporting requirements, including those pursuant to the Securities Exchange Act of 1934, the Sarbanes-Oxley Act, etc.

Private BDCs

Private BDCs: Overview

- Sponsored by large private equity firms with existing investor base.
- Operate similarly to non-traded BDCs, but draw down capital via a capital call model to fund investments (similar to a private fund).
- Shares offered to the sponsor's existing investor base through private placement offering rather than through a continuous public offering.
- BDC/RIC structure mitigates need for offshore feeder fund structure for foreign/tax exempt investors.

Private BDCs: Private Offering Process

- Form the entity (typically formed as a Delaware or Maryland corporation)
- File a registration statement on Form 10 to register a class of securities under the Exchange Act.
 - No registration statement on Form N-2 needs to be filed under the Securities Act.
- Prepare a private placement memorandum and subscription agreement for the private offering.
- Make an election to be regulated as a BDC by filing a Form N-54A.
- Comply with regulatory requirements under the Investment Company Act of 1940 and reporting requirements under the Securities Exchange Act of 1934, the Sarbanes-Oxley Act, etc.

Private BDCs: General Solicitation

- In September 2013, the SEC adopted amendments to Rule 506 under Regulation D and Rule 144A under the Securities Act to implement elements of the JOBS Act.
- Amendments made private BDC offerings more attractive.
 - Eliminated the prohibition on using general solicitation under Rule 506.
 - Issuers can offer securities through means of general solicitation under Rule 506(c), provided that:
 - All purchasers in the offering are accredited investors;
 - The issuer takes reasonable steps to verify each purchaser's accreditator investor status; and
 - Certain other conditions under Regulation D are satisfied.

Private BDCs: Initial Portfolio Acquisitions

- Initial portfolio may be acquired from an affiliated fund pre-IPO.
- Considerations in connection with initial portfolio acquisitions:
 - Approvals required at the private fund level.
 - Funding/timing issues on a pre-BDC basis.
 - Use of a bridge facility or notes.
 - Equity may be issued under certain circumstances.
 - Tax implications.
 - Timing and recognition of accrued but unrealized appreciation/depreciation in initial portfolio.
 - Disclosure requirements in connection with the initial portfolio.
 - Audited schedule of investments is typically required.

Non-Traded BDCs

Non-Traded BDCs: Overview

- Enable retail investors that meet certain suitability standards to participate in the upside of pre-IPO investing.
 - Shares not listed on an exchange but issued on a continuous basis.
 - Price volatility of shares reduced through adjustment of the public offering price to ensure shares are never sold below NAV.
 - Non-traded issuers typically offer to repurchase a portion of outstanding shares on a quarterly basis.
 - Periodic tenders by closed-end funds (including BDCs) are excepted from Regulation M under the Securities Exchange Act of 1934 if made at NAV or if in compliance with Rule 23c-3 of the Investment Company Act of 1940.
 - Certain BDCs have received no action relief under Regulation M for repurchase programs that set the repurchase price above or below NAV.
 - Offering must be registered in each state in which offers and sales are made.
 - Almost all non-traded BDCs with current offerings and in registration are externally managed.

Non-Traded BDCs: Rules Specific to Non-Traded BDCs

- Suitability requirements
 - May only sell securities to investors who meet certain suitability standards, typically through broker-dealer or RIA channels.
- FINRA review
 - More time-consuming and thorough review than the traded BDC process.
- State blue sky review
 - Must be approved to sell securities in each state in which solicitations will occur, which requires compliance with the “Omnibus Guidelines” published by the National Association of State Securities Administrators.
- Continuous offering over a period of time
 - Prospectus supplements filed periodically to report material events and provide updates on fundraising efforts and portfolio composition.

Non-Traded BDCs: Rules Specific to Non-Traded BDCs (cont'd)

- Liquidity event
 - Typically completed within 5-7 years following completion of offering.
 - Liquidity events can include:
 - Sale of all or substantially all assets either on a complete portfolio basis or individually followed by a liquidation;
 - Listing of shares on a national securities exchange; or
 - Merger or another transaction in which shareholders receive cash or shares of a publicly traded company

Non-Traded BDCs: Blue Sky Laws

- Must comply with the “Blue Sky Laws” under the NASAA Omnibus Guidelines.
- Sponsor Requirements
 - Sponsor must have adequate experience and net worth.
 - Limited indemnification of Sponsor, which may affect charter of the issuer.
- Suitability of Investors
 - Default minimum suitability standards either \$70,000 gross income and \$70,000 net worth or \$250,000 net worth.
 - Suitability standards may vary among states.
 - States may impose concentration restrictions (i.e., 10% of net worth in all non-traded BDCs).
 - Minimum investment amounts.
 - Suitability typically determined through the subscription agreement.

Non-Traded BDCs: Blue Sky Laws (cont'd)

- Rights and Obligations of Participants (i.e., stockholders)
 - 10% holders have right to call stockholder meetings.
 - Majority approval of stockholders required to amend charter, dissolve the company, remove the Sponsor, elect a new Sponsor or approve the sale of substantially all of the assets of the company.
 - Stockholder right to inspect and copy the company's records, including stockholder list.
 - Distribution Reinvestment Plans ("DRPs") may not charge sales commissions for shares issued under the DRP.
 - Stockholders must have the right to elect or revoke participation in the DRP.

Part III: Regulatory and Reporting Requirements

Regulatory and Reporting Requirements: SEC Reporting

- Form 10-K (Annual Report)
- Form 10-Q (Quarterly Report)
- Form 8-K (Current Report)
- Proxy Statements
- Sections 13 and 16 Filings
 - Forms 3, 4 or 5 for reporting beneficial ownership by directors, executive officers and >10% shareholders
 - Schedules 13D and 13G for reporting beneficial ownership by >5% shareholders
- Regulation FD

Regulatory and Reporting Requirements: SEC Reporting (cont'd)

- Compliance with the Sarbanes-Oxley Act of 2002
- Disclosure Control and Procedures
- Internal Control over Financial Reporting/Attestation
 - JOBS Act provides that “emerging growth companies” may take advantage of reduced reporting obligations, including with respect to the auditor attestation report on internal control over financial reporting, for a certain period of time

Regulatory and Reporting Requirements: Financial Statements

- Valuation
- Fair value and Level 3 reconciliation tables
- Control investments, investments in affiliates vs. investments in non-affiliates
- Schedule of investments requires disclosure of (among other things):
 - Name and address of each portfolio investment
 - Details of each portfolio investment (i.e., interest rate, maturity date)
 - Non-income producing investments
 - Assets held in securitized vehicles
- Concentration
 - Geography and industry sectors
- Regulation G reconciliation of non-GAAP financial measures

Regulatory Requirements: “Good” vs. “Bad” Assets

- BDC must invest 70% of its assets in “good” BDC assets.
 - “Good” assets include securities issued by an “eligible portfolio company,” as defined in Section 2(a)(46), including:
 - U.S. issuers that are neither an investment company as defined in Section 3 (other than a wholly-owned SBIC) nor a company that would be an investment company except for the exclusion from the definition of investment company in section 3(c) AND
 - Do not have any class of securities listed on a national securities exchange; OR
 - Have a class of securities listed on a national securities exchange, but have an aggregate market value of outstanding voting and non-voting common equity of less than \$250 million.
- The remaining 30% of the basket can generally include “bad” assets.
 - The SEC Staff has never been called upon to consider whether utilizing a specific strategy for the “30% basket” (i.e., investing solely in foreign companies) might run afoul of the intent of Section 55(a).

Regulatory and Reporting Requirements: Limitations on Borrowings

- Under the 1940 Act, BDCs must have 200% asset coverage (Total Assets/Total Debt).
- Under the Small Business Credit Availability Act, passed by Congress on March 23, 2018 (the “SBCAA”), BDCs that meet certain specified conditions may elect to decrease their asset coverage to 150%, representing approximately a 2-to-1 debt-to-equity ratio.
 - Requires approval of its board of directors, including a majority of its directors who are not “interested persons;” OR
 - Will not take effect until one year following receipt of such board approval.
 - Requires the approval of a majority of the votes cast by its stockholders at an annual or special meeting thereof at which a quorum is present
 - May take effect immediately following the date of such approval.
 - BDCs that obtain such approval will need to disclose the approval no later than five business days after such approval is obtained and will be subject to ongoing disclosure obligations with respect to its leverage arrangements.
 - Non-traded and private BDCs must extend to each person who is a shareholder as of the date of the approval the opportunity to sell their securities, with 25% of those securities to be repurchased in each of the four calendar quarters following the calendar quarter in which that approval date falls
 - SEC has issued guidance which allows for more flexibility in structuring the repurchases
- Other investment companies are restricted to a 300% asset coverage requirement for debt issuance.
- BDCs may exclude leverage at the SBIC level if the SEC grants exemptive relief, which many BDCs have received.

Regulatory and Reporting Requirements: Affiliate Transactions

- Section 57 addresses the ability of BDCs to engage in certain types of transactions with affiliates.
 - Section 57 is less onerous than its counterpart for registered investment companies, Section 17.
- Depending on the nature of the affiliation with the BDC, transactions involving a BDC and one or more of its affiliates require either:
 - Authorization by the required majority of the board of directors, including a majority of the disinterested board members; or
 - An order of the SEC.
- Co-investment between a BDC and an affiliated fund generally requires SEC exemptive relief.
 - Mass Mutual exception (i.e., no terms negotiated other than price).

Regulatory and Reporting Requirements: 1940 Act Requirements

- BDCs must have a majority of independent directors serving on the board of directors, i.e., persons who are not “interested persons” as defined in Section 2(a)(19) of the 1940 Act.
- BDCs must make available significant managerial assistance to portfolio companies.
- Custodian Agreement
 - A BDC generally must place and maintain its securities and similar investments in the custody of a bank qualified under Section 26(a)(1) of the 1940 Act or a broker dealer.
- Fidelity Bond
 - BDCs must provide and maintain a bond issued by a reputable fidelity insurance company to protect the company against larceny and embezzlement. The bond must cover each officer and employee with access to securities and funds of the company.
- Code of Ethics
 - BDCs must maintain and enforce standards of conduct for officers and directors of the BDC through a Code of Ethics.
 - The Code of Ethics must require reporting of all securities holdings and transactions.

Regulatory and Reporting Requirements: 1940 Act Requirements (cont'd)

- Restrictions on Investing in Other Investment Companies
 - A BDC may not invest:
 - in more than 3% of the outstanding voting stock of an investment company/BDC;
 - more than 5% of the value of its total assets in an investment company/BDC; or
 - more than an aggregate of 10% of its total assets in investment companies/BDCs.
 - SEC has proposed rules to relax some of these restrictions
- Restrictions on investment funds investing in a BDC
 - Neither a public (i.e. registered or BDC) or private investment fund may own more than 3% of the outstanding voting stock of a BDC.
 - Public funds are also subject to the 5% and 10% restrictions noted above

Regulatory and Reporting Requirements: 1940 Act Requirements (cont'd)

- Limitations on Indemnification
 - A BDC is prohibited from protecting any director or officer against any liability to the company, or its security holders, arising from willful misfeasance, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of such person's office
- Bookkeeping and records requirements
 - Must maintain and make available for inspection prescribed books and records.

Regulatory and Reporting Requirements: 1940 Act (cont'd)

- Must appoint a Chief Compliance Officer
- A BDC must maintain a compliance program pursuant to Rule 38a-1 of the 1940 Act, which requires:
 - Adoption and implementation of policies and procedures designed to prevent violation of the federal securities laws;
 - These policies and procedures required to be reviewed annually for their adequacy and the effectiveness of their implementation; and
 - Appointment of a chief compliance officer to administer the compliance policies and procedures.
- Investment adviser must maintain a compliance program pursuant to Rule 206(4)-7 of the Investment Advisers Act of 1940, which requires:
 - Adoption and implementation of compliance policies and procedures.
 - Maintenance and enforcement of a code of ethics for adviser's employees.
- Subject to periodic examination by the SEC staff

Regulatory and Reporting Requirements: Asset Valuation

- Assets must be valued on a quarterly basis
 - Market value is used for those assets for which market quotations are readily available.
 - ASC 820 requires that public companies' financial instruments generally be valued at their current market price (i.e., "mark to market").
 - "Fair value," as determined by the board of directors, is used for other securities and assets.
 - There is no single standard for determining fair value in good faith.
 - Determining fair value requires judgment of the specific facts and circumstances of each portfolio investment while employing a consistently applied valuation process.
 - Each debt and equity security is separately valued.
- BDCs are not permitted to sell shares below NAV without shareholder approval
 - Approval must be obtained annually.
 - Markets have imposed limitations on how much a BDC can sell below NAV.

Regulatory and Reporting Requirements: Exemptive Relief

- BDCs may seek to receive an SEC order granting exemptive relief permitting (among other things):
 - Co-investment among affiliates.
 - Ownership of a registered investment adviser.
 - Exclusion of leverage from the asset coverage calculation for debt held by an SBIC subsidiary.
 - Issuance of restricted stock options to independent directors and employees of internally-managed BDCs.
- Exemptive relief process may take from 6 to 18 months
 - Typically based on precedent.

Regulatory and Reporting Requirements: NASDAQ/NYSE Listing Standards

- BDCs with securities listed or traded on NASDAQ or NYSE must comply with corporate governance listing standards, including:
 - An audit committee composed solely of “independent directors” (as defined by the applicable exchange or association).
 - Director nominees selected by a nominating committee or the vote of a majority of independent directors (depending on the exchange).
 - Non-management, or “independent,” directors must hold regularly scheduled executive sessions.
 - Adoption of a code of business conduct and ethics, various committee charters and, for NYSE-listed BDCs, corporate governance guidelines.
 - All such documents must be posted on the company’s website.

Part IV: Management and Operational Considerations

Management and Operational Considerations: Internally-Managed Structure

- BDC is managed internally by executive officers (i.e., no external adviser).
- Must comply with SEC executive compensation disclosure requirements.
- Certain equity incentive compensation is permitted, including:
 - Issuance of at-the-market options, warrants, or rights pursuant to an executive compensation plan; or
 - Maintenance of a profit sharing plan.
 - Otherwise, the BDC must use cash assets as compensation.
- Exemptive orders permitting the issuance of restricted stock have been issued in a number of circumstances including:
 - Hercules Capital, Inc.
 - Main Street Capital Corporation

Management and Operational Considerations: Externally-Managed Structure

- Portfolio managed by external investment adviser.
- Investment adviser must be registered under the Advisers Act.
- May utilize an external administrator to provide administrative services to the BDC
- Adviser is permitted to take a base management fee, as well as an incentive fee on both:
 - Investment income
 - Realized capital gains
- Contrasts with most registered closed-end funds, which are typically prohibited from taking an incentive fee on capital gains.
- Incentive fees are often subject to hurdle/catch-up features.

Management and Operational Considerations: Calculation of Adviser's Incentive Fee

- SEC Staff has taken no formal position on the calculation of the fee but requires BDCs to include extensive disclosure in registration statements regarding the manner in which the fee will be calculated in varying scenarios.
- Section 205(b)(3) of the Advisers Act permits external investment advisers of BDCs to receive capital gains incentive fees, provided that the BDCs do not have outstanding any equity-based compensation arrangement or profit-sharing plan.
 - Section 205(b)(3) provides an exception from the general prohibition on an investment adviser charging an incentive fee based on a share of capital gains.
 - Advisers may assess an incentive performance fee of up to 20% on a BDC's realized capital gains net of all realized capital losses and unrealized capital depreciation over a specified period.

Management and Operational Considerations: Portfolio Valuation Process

- Investments are reported at fair value, as determined in good faith by the board of directors.
- ASC 820 – Fair Value Measurements and Disclosures
 - “Fair value” is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at measurement date.
- Key Controls in the Valuation Process:
 - Documented approval of trades.
 - Controls over inputs in valuation write-ups.
 - Segregation between preparation and review of valuations.
 - Use of independent third-party valuation consultants to assist.
 - Identified and monitored problem loans.
 - High level analytical reviews.
 - Completeness of disclosures.
 - All controls evidence Sarbanes-Oxley 404 readiness.

Management and Operational Considerations: General Principles of Valuation

- Investments must be classified into three levels:
 - **Level 1:** Inputs are unadjusted, quoted prices in active markets for identical financial instruments at the measurement date.
 - **Level 2:** Inputs include quoted prices for similar financial instruments in active markets and inputs that are observable for the financial instruments, either directly or indirectly, for substantially the full term of the financial instrument.
 - **Level 3:** Inputs include significant unobservable inputs for the financial instruments and include situations where there is little, if any, market activity for the investment. The inputs into the determination of fair value are based upon the best information available and may require significant management judgment or estimation.
- Majority of BDCs classify debt and equity investments as Level 3 instruments.
- Debt investments with broker quotes may be considered a Level 2 instrument (broadly syndicated loans).

Management and Operational Considerations: Factors That Impact Valuation

- General Economic Factors
 - Changes in interest rates and credit spreads and return on equity.
 - Changes in aggregate demand level.
 - Changes in economic outlook.
- Industry Factors
 - Change in supply or demand for product.
 - Change in competition.
 - Barriers to entry.

Management and Operational Considerations: Factors That Impact Valuation

- Company Specific Factors
 - Current and expected life cycle of company
 - Achievement of milestones
 - Company performance relative to projections
 - Experience and competence of the top management team and board of directors
 - Existence of intellectual capital and intangible assets
 - Proprietary technology, products, or services
 - Quality of work force
 - Strategic relationships with major suppliers or customers
 - Cost structure and financial condition

Management and Operational Considerations: Taxation as a RIC

- A BDC may elect to be taxed as a "regulated investment company," or RIC, under the Subchapter M of Internal Revenue Code.
- Taxation as a RIC:
 - Allows "pass through" tax treatment for income and capital gains that are distributed to shareholders.
 - Must distribute at least 90% of its investment income to shareholders annually, and 98% to avoid excise tax.
 - May retain, distribute or "deem distribute" capital gains.
 - 90% of annual gross income must be "good" RIC income.
 - Interest, dividends, gains, and some types of fees.

Management and Operational Considerations: Taxation as a RIC (cont'd)

- Taxation as a RIC (cont'd):
 - Quarterly diversification tests:
 - At least 50% of total assets must be invested in cash, government securities, RIC securities, and "other" securities, which cannot be more than 5% of a RIC's total assets OR more than 10% of an issuer's voting stock.
 - No more than 25% of RIC's assets may be invested in any one issuer (or in similar businesses if the RIC controls).
 - No more than 25% of RIC's total assets may be invested in QPTPs.
- Conversion to RIC status
 - Built-in gains must be considered at formation.

Part V: Changes in Legislation

Small Business Credit Availability Act

- On March 23, 2018, Congress passed and President Trump signed the Consolidated Appropriations Act of 2018, which included the SBCAA.
- Amends the 1940 Act to permit BDCs to reduce their required asset coverage from 200% to 150%, subject to certain initial approval (by board OR shareholders) and ongoing reporting requirements.
- Directs the SEC to amend certain rules and forms to streamline the registration and reporting process for BDCs, reducing disparities in treatment for BDCs as compared to other registrants under the 1933 Act.
 - BDCs now eligible to qualify as "well-known seasoned issuers" (or "WKSI"), which face fewer communication restraints and more convenient offering procedures, and allows BDCs that qualify as WKSIs to file automatic shelf registration statements.
 - Allows BDCs eligible as WKSIs to use free writing prospectuses for offerings, even before filing a registration statement.
 - Qualifying BDCs will also be able to use free writing prospectuses after filing a registration statement that includes a preliminary or base prospectus
 - Instructs the SEC to revise Form N-2 to provide that any BDC that meets the requirements for use of Form S-3 may incorporate by reference its reports and documents filed under the 1934 Act into its registration statement filed on Form N-2.
 - Permits BDCs to incorporate information that they already file into registration statements under the 1933 Act.

Impact of the Volcker Rule

- Final Dodd-Frank Volcker Rule issued December 2013.
 - Generally prohibits banking entities from:
 - Engaging in short-term proprietary trading; or
 - Investing in, or having certain relationships with, hedge funds and private equity funds, referred to as "covered funds" under the Volcker Rule.
 - BDCs are excluded from the definition of "covered fund" under the Volcker Rule.
 - As a result, a banking entity generally may invest in a BDC, including one that potentially engages in activities subject to restriction under the Volcker Rule, so long as that banking entity does not hold the power to vote 25% of such BDC's voting shares and provided that it is otherwise permitted to do so under applicable banking law.
 - Likewise, a banking entity may manage such a BDC, so long as it does so in compliance with applicable securities and banking law.
 - As written, the Volcker Rule potentially creates incentives for banks to invest or form in BDCs.

Impact of the JOBS Act on BDCs

- Designed to encourage capital formation for small U.S. businesses.
- Permits "emerging growth companies" (EGCs) to confidentially file an initial registration statement.
 - EGC is defined as having less than \$1 billion total annual gross revenues in its most recent fiscal year.
- EGCs are exempt from certain requirements of the Sarbanes-Oxley Act.
 - EGCs planning an IPO have more time to ramp up their SOX programs, allowing the companies to focus on expanding their business.
 - For the five years following an IPO, EGCs are not required to comply with Section 404(b) of SOX, which requires external auditors to attest to the EGC's internal controls over financial reporting unless:
 - The company's revenue grows to more than \$1,070,000,000;
 - The company issues more than \$1 billion in nonconvertible debt over a three-year period; or
 - The company's worldwide public equity float exceeds \$700 million.
- EGCs must continue to comply with the other provisions of SOX, including management reports/certifications relating to internal control over financial reporting.

Future Legislative/Regulatory Changes Sought by the BDC Industry

- Industry has continued to seek to modernize the BDC model since 2001.
- Efforts led by Small Business Investor Alliance and several BDC management teams.
 - AFPE relief, tax parity and co-investment changes

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For further information, visit our website at [dechert.com](https://www.dechert.com).

Dechert practices as a limited liability partnership or limited liability company other than in Dublin and Hong Kong.