Business Development Companies
What Are BDCs?

- A business development company ("BDC") is a special investment vehicle used to facilitate capital formation by smaller companies
  - Sometimes referred to as “public private equity”

- A BDC is a type of closed-end “investment company” under the Investment Company Act of 1940 ("1940 Act")
Why Are BDCs Popular?

- There have been a number of public offerings by BDCs
- BDCs provide access to the public (retail) market
- BDCs have permanent capital (not subject to redemption)
- Managers may charge higher fees; unlike other 1940 Act companies, BDCs may pay performance-based fees
- May be an efficient way to invest in distressed assets
- Approximately 48 listed BDCs as of December 31, 2013
1940 Act Registration

• A BDC elects to register under the 1940 Act

• Section 2(a)(48) of the 1940 Act defines a BDC as:

“a domestic closed-end company that (i) operates for the purpose of making investments in certain securities specified in Section 55(a) of the 1940 Act and, with limited exceptions, makes available “significant managerial assistance” with respect to the issuers of those securities; and (ii) has elected BDC status.”
Types of Investments

• A BDC must maintain at least 70% of its investments in eligible assets before investing in non-eligible assets

• Eligible assets include:
  • Privately issued securities purchased from issuers that are “eligible portfolio companies” (or from certain affiliated persons)
  • Securities of eligible portfolio companies controlled by a BDC and of which an affiliated person of a BDC is a director
  • Privately issued securities of companies subject to a bankruptcy proceeding (or similar proceeding)
  • Cash and cash equivalents or short-term high quality debt securities; and
  • Property and real estate necessary to operate the BDC
Eligible Portfolio Company

• Must be a domestic issuer that either:
  • Does not have a class of listed securities
  OR
  • Has a class of listed securities but has an aggregate market value of outstanding common equity of less than $250 million and meets certain other specified requirements
Significant Managerial Assistance

• A BDC must make available significant managerial assistance to those companies that the BDC treats as satisfying the 70% standard

• Significant managerial assistance includes arrangements whereby directors, officers, employees or affiliates of the BDC offer to provide, and if accepted, does so provide, guidance on the management, operations or business of the company in question

• The requirement also is satisfied if the BDC exercises a controlling interest (presumed if the BDC owns 25% or more of the voting stock) in the company in question
Affiliate Transactions

• BDCs are subject to limitations on related party transactions

• Unlike most investment companies, BDCs are not subject to the some of provisions of Section 17 of the 1940 Act, including restrictions on transactions involving sale of property to a BDC and “joint Transactions”
  • BDCs are, however, subject to Sections 17(f) through 17(j) to the same extent as if they are registered closed-end funds

• BDCs are subject to the limitations of Section 57, which are more permissive than Section 17(a) through (e)
Restricted Transactions

• Section 57 identifies four types of restricted transactions:
  • An affiliate may not knowingly sell any securities or other property to the BDC or a company controlled by it, unless the BDC is the issuer, or the affiliate is the issuer, and the security is part of a general offering
  • An affiliate may not knowingly purchase from the BDC or a company controlled by it any security or other property, except securities issued by the BDC
  • An affiliate may not knowingly borrow money or other property from the BDC or a company controlled by it (subject to limited exceptions)
  • An affiliate is prohibited from knowingly effecting any joint transactions with the BDC or a company controlled by it in contravention of SEC rules
Restricted Transactions (cont’d)

• Depending on the nature of the proposed transaction approval will be required:
  • Either by the majority of the board of directors, including a majority of disinterested members
  or
  • Exemptive relief from the SEC

• Historically, the SEC Staff has granted exemptive relief for joint investments and joint exits, subject to compliance with a number of conditions intended to protect investors
Restricted Transactions (cont’d)

• First Tier Affiliates: Restricted Transactions with the following “first tier affiliates” of a BDC are prohibited unless the BDC receives prior approval from the SEC:
  • Any director, officer or employee of the BDC
  • Any entity that a director, officer or employee of the BDC controls
  • A BDC’s investment adviser, promoter, general partner or principal underwriter, or any person that controls or is under common control with such persons or entities or is an officer, director, partner or employee of any such entities
Restricted Transactions (cont’d)

- Second Tier Affiliates: Restricted Transactions with the following “second tier affiliates” are prohibited unless a majority of the directors or general partners who are not interested persons of the BDC (as defined in the 1940 Act) and who have no financial interest in the transaction approve the transaction
  - Any 5% shareholder of the BDC, any director or executive officer of, or general partner in, a 5% shareholder of the BDC, or any person controlling, controlled by, or under common control with such 5% shareholder
  - Any affiliated person of a director, officer or employee, investment adviser, principal underwriter for or general partner in, or of any person controlling or under common control with, the BDC
Restricted Transactions (cont’d)

• Controlled Affiliates: A “controlled affiliate” is a downstream affiliate of a BDC whose securities are more than 25% owned by the BDC.

• A controlled affiliate is treated the same as a second tier affiliate when engaging in Restricted Transactions with the BDC.
  • It also is important to note, however, that the affiliated transaction prohibitions of Section 57 “flow-through” to all controlled affiliates of the BDC.
  • For example, if a BDC owns 30% of Company A, Company A could not purchase securities from a first tier affiliate of the BDC, unless the BDC receives prior SEC approval.
Management of the BDC

• A BDC may be internally or externally managed

• An externally managed BDC must enter into an investment management agreement with the manager and that agreement will be subject to various 1940 Act requirements, including:
  • Board approval (initially and annually) and
  • Shareholder approval

• The investment adviser also will be subject to a conflicts policy and must be registered under the Investment Advisers Act of 1940
Fees

• A BDC may pay its manager performance-based compensation.
  • A “base” management fee
  • An “incentive” fee

• Performance-based compensation will be subject to the various restrictions and limitations imposed by the 1940 Act
  • An externally managed BDC that receives an incentive fee cannot participate in an equity-based compensation plan
Capital Structure

• A BDC is subject to certain limitations on its capital structure:
  • Asset coverage of 200%  
    • Debt and senior securities cannot exceed half of the BDC’s total assets.  
    • No dividends can be declared on common stock unless the BDC’s debt and senior securities have asset coverage of 200%  
  • May issue common stock, more than one class of senior secured debt, and warrants and options (subject to certain requirements)  
  • Legislation has been proposed that would modify these requirements

• A BDC usually must sell shares of its common stock at net asset value (“NAV”) – unless it has received shareholder approval, or it is engaging in a rights offering  
  • A BDC may consider seeking approval from its shareholders at its annual meeting so that it has additional operating flexibility
Tax Considerations
**Tax Character**

- BDCs are typically organized as limited partnerships in order to obtain pass-through tax treatment.

- However, a BDC cannot be a “publicly traded partnership” for federal income tax purposes.

- Thus, if the BDC is to be a partnership for tax purposes, either (a) its interests cannot be traded on an exchange or on a secondary market or equivalent, or (b) it must qualify for one of the exceptions to treatment as a “publicly traded partnership” for U.S. federal income tax purposes.

- More recently, some BDCs have been organized as corporations and have opted to be treated as Regulated Investment Companies for tax purposes.
Regulated Investment Companies

• BDCs may also be organized as corporations and obtain pass-through tax treatment by qualifying as regulated investment companies ("RICs") under Subchapter M of the Internal Revenue Code of 1986, as amended

• To qualify as a RIC, a BDC must, among other things, elect to be treated as a RIC, distribute substantially all (e.g., 90%) of its taxable income each year and meet certain income and asset diversification tests
Regulated Investment Companies

• Income Test:

  • At least 90% of a RIC’s gross income must be derived from passive sources:
    • Dividends
    • Interest (including tax-exempt interest income)
    • Payments with respect to securities loans
    • Gains from the sale or other disposition of stock or securities or foreign currencies
    • Other income (including gains from options, futures, or forward contracts) derived from the RIC's business of investing in such stock, securities, or currencies
    • Net income derived from an interest in a qualified publicly traded partnership
Regulated Investment Companies

• Income Test (continued):

  • Income from a partnership or trust qualifies to the extent the RIC's distributive share of such income is from items described above as realized by the partnership or trust
Regulated Investment Companies

• Asset Diversification Test:

  • At the close of each quarter during the taxable year, a RIC must be adequately diversified, by meeting both the 50% Asset Test and 25% Asset Test

  • 50% Asset Test – At least 50% of the total value of the RIC’s assets must be represented by
    • Cash
    • Cash items (including receivables)
    • Government securities
    • Securities of other RICs
    • Diversified Securities
Regulated Investment Companies

• Asset Diversification Test (continued):

• For these purposes, Diversified Securities are securities that, with respect to any one issuer, are not worth more than 5% of the RIC’s assets and which are no more than 10% of the issuer’s voting securities
  • For example, assume that a RIC owns securities issued by Corporation X
  • Assuming that Corporation X is not a RIC itself, in order to count towards the 50% Asset Test, the value of those securities must be less than 5% of the RIC’s total assets and the securities owned by the RIC must be less than 10% of the voting securities of Corporation X

• Assets that are not “securities” (other than cash and cash items) do not count towards satisfying the 50% Asset Test
Regulated Investment Companies

• Asset Diversification Test (continued):

  • 25% Asset Test – Not more than 25% of the total value of the RIC’s assets can be invested in:
    • The securities of any one issuer, except for Government securities or the securities of other RICs
    • The securities of two or more issuers that the RIC controls (other than other RICs)
    • The securities of one or more qualified publicly traded partnerships

  • Assets that are not “securities” are not subject to the 25 percent Asset Test limit
Regulated Investment Companies

• Generally, distributions by a BDC are taxable as either ordinary income or capital gains in the same manner as distributions from mutual funds and closed-end funds, and a BDC shareholder will recognize taxable gain or loss when it sells its shares.
Registration and Reporting
Registration Process

• A BDC must file:
  • A Form N-6, which is an intent to file a notification of election
  • A Form 54A, which is an election to be registered as a BDC and
  • A registration statement on Form N-2, which provides basic information about the BDC (e.g., the terms of the offering, the intended use of proceeds, the investment objectives and policies of the BDC, risk factors associated with an investment in the BDC, and information regarding the management of the BDC)

• A BDC must also register a class of securities on an exchange
Emerging Growth Company Status

• A BDC may qualify as an “emerging growth company” (“EGC”), which is a new category of issuer under the JOBS Act
  • An EGC is an issuer with total annual gross revenues of less than $1 billion (with such threshold indexed to inflation every five years), and would continue to have this status until: (i) the last day of the fiscal year in which the issuer had $1 billion in annual gross revenues or more; (ii) the last day of the fiscal year following the fifth anniversary of the issuer’s IPO; (iii) the date on which the issuer has, during the previous three-year period, issued more than $1 billion in non-convertible debt; or (iv) the date when the issuer is deemed to be a “large accelerated filer” as defined by the SEC
  • However, a BDC issuer will not be able to qualify as an EGC if it first sold its common stock in an IPO prior to December 8, 2011

• In order to qualify for the accommodations permitted to EGCs, a BDC would have to elect to be treated as an EGC
  • Any election must be made at the time the EGC files its first registration statement or Exchange Act report
Emerging Growth Company Status (cont’d)

- The benefits for a BDC of qualifying as an EGC include the following:
  - May file a registration statement with the SEC on a confidential basis
  - Expanded range of permissible pre-filing communications made to qualified institutional buyers or institutional accredited investors
  - Only need to provide two years of audited financial statements to the SEC (rather than three years), and the auditor attestation on internal controls requirement may be delayed
  - Exemption from the mandatory say-on-pay vote requirement and the Dodd-Frank Act required CEO pay ratio rules (to be adopted by the SEC), and the ability to use certain smaller reporting company scaled disclosure
  - No requirement to comply with any new or revised financial accounting standard until the date that such accounting standard becomes broadly applicable to private companies
  - No longer subject to any rules requiring mandatory audit firm rotation or a supplement to the auditor’s report that would provide additional information regarding the audit of the issuer’s financial statements (no such requirements currently exist)
Ongoing Reporting Obligations and Governance Issues

- Subject to the Securities Act of 1933 and the Securities Exchange Act of 1934, a BDC must:
  - File periodic, quarterly and annual reports and proxy statements
  - Prepare quarterly and annual financial statements identifying the current fair value of each portfolio company

- Subject to the requirements of the Sarbanes-Oxley Act of 2002

- Subject to the rules and regulations of the exchange on which the BDC’s securities are listed
Ongoing 1940 Act Requirements

• A majority of independent directors
  • Persons who are not “interested persons” (Section 2(a)(19) of the 40 Act).

• A custodian
  • Securities must be held by a custodian meeting requirements of Section 26(a)(1) of the 40 Act

• Fidelity bond covering officers and employees

• Code of ethics
  • The code must, among other things, address investments by officers and directors, and transactions among related parties, as well as reporting and recordkeeping
Ongoing 1940 Act Requirements (cont’d)

• Restrictions on investments in other investment companies and restrictions on percentage interest of BDC held by an investment fund

• Limitations on indemnities

• Bookkeeping and records requirements (Rules 3(a)-1(b), 31a-2(a), 31a-3)

• Compliance policies and procedures (38a-1)

• Registered investment adviser must have policies and procedures (206(4)-7)
CPO Registration Not Required

• The CFTC has issued no-action letter guidance that it will not require a BDC’s adviser to register with the NFA as a commodity pool operator (“CPO”) so long as:
  • The BDC has elected to be treated as a BDC under Section 54 of 1940 Act, and continues to be regulated by the SEC as a BDC
  • The BDC will not be, and has not been, marketing participations to the public as or in a commodity pool or otherwise as or in a vehicle for trading in the commodity futures, commodity options, or swaps markets, and
  • Either:
    • The BDC uses commodity futures or commodity options contracts, or swaps solely for bona fide hedging purposes, or
    • The aggregate net notional value of commodity futures, commodity options contracts, or swaps positions not used solely for bona fide hedging purposes does not exceed 100% of the liquidation value of the BDC’s portfolio, after taking into account unrealized profits and unrealized losses on any such positions it has entered into
FINRA
Rule 2310 – REITs and Direct Participation Programs

• Direct participation programs ("DPP")
  • "Flow-through" tax consequences regardless of legal entity structure
  • Oil and gas limited partnerships
  • Real estate limited partnerships
  • Agricultural and cattle programs

• Does not include real estate investment trusts ("REITs")

• Applies to business development companies (BDCs)

• Parts of Rule 2310 do apply to REITs, whether in corporate or trust form

• Prohibits members and persons associated with members from participating in a DPP public offering, a limited partnership roll-up transaction (as defined), or, certain REIT transactions, unless the requirements of the Rule are met with respect to
  • Investor suitability
  • Disclosure obligations
  • Organization and offering expenses
  • Valuation of customer accounts
  • Non-cash compensation

• May apply to institutional and other investors, irrespective of FINRA member participation
Rule 2310 – Suitability Requirements

• Applicable to DPP underwriting or participating in a public offering of a DPP unless securities are being listed on an exchange

• Specific suitability requirements established and disclosed, including reasonable grounds to believe:
  • the participant is or will be in a financial position appropriate to enable him to realize to a significant extent the benefits described in the prospectus, including the tax benefits where they are a significant aspect of the program
  • the participant has a fair market net worth sufficient to sustain the risks inherent in the program, including loss of investment and lack of liquidity
  • the program is otherwise suitable for the participant

• No member shall execute any DPP transaction in a discretionary account without prior written approval of the transaction by the customer
Rule 2310 – Disclosure Requirements

• Applicable to participation in a DPP or REIT public offering
• Members and associated person must have reasonable grounds to believe “all material facts are adequately and accurately disclosed and provide a basis for evaluating the program”
• To make such determination, a member shall obtain information on material facts relating to, at a minimum and to extent relevant:
  • items of compensation
  • physical properties
  • tax aspects
  • financial stability and experience of the sponsor
  • the program's conflict and risk factors
  • appraisals and other pertinent reports
Rule 2310 – Informing Participants

• Prior to executing a purchase transaction in a DPP or a REIT, a member or associated person shall inform the prospective participant of all pertinent facts relating to the liquidity and marketability of the program or REIT during the term of the investment.

• Pertinent facts include information regarding
  • whether the sponsor has offered prior programs or REITs in which disclosed in the offering materials was a date or time period at which the program or REIT might be liquidated, and whether the prior program(s) or REIT(s) in fact liquidated on or around that date or during the time period

• Does not apply if the DPP or REIT securities are being listed on an exchange
Rule 2310 – Organization and Offering Expenses

• No member or associated person shall underwrite or participate in a DPP or REIT public offering if the organization and offering expenses are not fair and reasonable

• Arrangements shall be presumed to be unfair and unreasonable if:
  • OOE exceed 15% of the gross proceeds of the offering
  • total of all items of compensation, including compensation paid from offering proceeds and "trail commissions," payable to underwriters, broker-dealers, or affiliates thereof exceeds 10% of the gross proceeds of the offering
  • non-accountable expense allowance, when aggregated with all other such non-accountable expenses, exceeds 3% of offering proceeds
  • compensation paid to underwriters, broker-dealers, or affiliates thereof out of offering proceeds prior to the release of such proceeds from escrow
  • unregistered broker-dealers engaged by a potential investor receive commissions or other compensation as inducement to advise the purchase of interests in a particular DPP or REIT
  • sales load or commission on securities purchased through dividend reinvestment
Rule 2310 – Unlisted REITS and DPPs

- Ongoing SEC and FINRA concerns, particularly regarding per share estimated value
- Current Rule permits continuing disclosure of per share estimated value based on original gross offering price as long as seven years after initial offering
- In January 2014, FINRA has proposed revisions to
  - NASD Rule 2340 (Customer Account Statements) that require new methodology for disclosure of per share estimated value based on updated information
  - Rule 2310 that prohibit member participation in a public offering unless:
    - Per share estimated value is calculated on a period basis in accordance with a disclosed methodology
    - GP or Sponsor agree to disclose in first periodic report after second anniversary of breaking escrow specific information regarding per share estimated value calculated by or with material assistance of a third-party valuation expert, who is identified, the methodology used and the date of evaluation
Rule 5123 – Additional Unfair Expenses

• the DPP or REIT provides for compensation of an indeterminate nature to be paid to members or persons associated with members for sales of the program or REIT, or for services of any kind rendered in connection with or related to the distribution thereof, including
  • percentage of the management fee
  • profit sharing arrangement
  • brokerage commissions
  • over-riding royalty interest
  • net profits interest
  • percentage of revenues
  • reversionary interest
  • working interest
  • security or right to acquire a security having an indeterminate value
SBICs
What is an SBIC?

- Small business investment companies (SBICs) are privately owned and managed investment funds.
- SBICs are licensed and regulated by the Small Business Administration (SBA).
- The principal reason for a firm to become licensed as an SBIC is access to financing provided by the SBA.
- SBICs use their own capital, plus funds borrowed with an SBA guarantee to make equity and debt investments in qualifying small businesses.
- SBICs are designed to supply management assistance, equity capital, and long-term financing to small business concerns for their growth, expansion, and operations.
- SBICs are subject to regulatory requirements, including making investments in SBA eligible businesses, investing at least 25% of regulatory capital in eligible smaller businesses, placing certain limitations on the financing terms of investments, prohibiting investing in certain industries, required capitalization thresholds, and are subject to periodic audits and examinations among other regulations.
Advantages of an SBIC

- Regulatory Benefits – SBICs are not required to register with the SEC, relieving them of a significant regulatory and compliance burden. However, LPs benefit from the oversight of the SBA, reducing the risk of fraud and abuse.

- Rapid Deployment of Funds – With a leverage commitment from the SBA equal to two times, and sometimes three times the private capital raised, fund managers are able to minimize the time spent on fundraising and focus on making investments.

- Flexible Fund Structure – SBICs are permitted to organize as stand-alone entities, drop-down vehicles or side-car vehicles.

- Strong, Stable Returns – The low cost of SBA capital provides fund managers with pricing flexibility across cycles while the 10-year term on SBA debentures avoids the problems of duration mismatch.

- Community Reinvestment Act Credits – Investments in SBICs may be eligible for Community Reinvestment Act credits.

- The Opportunity of Small Business – Despite being the bedrock of the American economy, U.S. small businesses remain underserved and represent a value opportunity for investors.

- Banks – Attractive to banks, federal savings associations as well as their holding companies for a variety of reasons.
SBIC Investments

• SBICs must only invest in “small businesses”
  • “Small businesses” are defined as businesses with tangible net worth of less than $18 million AND an average of $6 million in net income over the previous two years at the time of investment
  • Companies failing that test may still qualify if they meet certain size standards for their industry group that are based on the number of employees (typically 500 to 1,000 for a manufacturing company) or gross revenues
  • Once an SBIC has invested in a company, it may continue to make follow-on investments in the company, regardless of the size of the business, up and until the time a business offers its securities in a public market

• SBICs must invest 25% of their capital in “smaller businesses”
  • “Smaller businesses” are defined as businesses with tangible net worth of less than $6 million AND an average of $2 million in net income over the previous two years at the time of investment
  • Once an SBIC has invested in a company, it may continue to make follow-on investments in the company, regardless of the size of the business, up and until the time a business offers its securities in a public market

• SBICs may not invest an amount greater than 30% of the SBIC’s private capital in any single portfolio company (with two tiers of SBA leverage, this means an SBIC may not invest more than 10% of their total capital (private + SBA) in any single portfolio company)

• SBICs may not invest in businesses with more than 49% of the employees located outside the U.S.

• SBICs may not invest in companies active in sectors deemed contrary to the public interest nor may they invest in project finance, real estate or financial intermediaries

• SBICs may not control small businesses for longer than 7 years without first obtaining approval from the SBA
SBIC Financing

• The SBA places certain limits on the financing terms of investments by SBICs in portfolio companies such as limiting the interest rate on debt securities and loans provided to portfolio companies of the SBIC.
• The SBA also limits fees, prepayment terms and other economic arrangements that are typically charged in lending arrangements.
BDCs with SBIC Subsidiaries

• Some SBICs have converted into BDCs
  • Main Street Capital Corporation
  • Triangle Capital Corporation

• BDCs have established subsidiaries licensed as SBICs
  • Hercules Technology Growth Capital
  • Medallion Capital Corporation
  • MCG Capital Corporation
  • Rand Capital Corporation

• The SEC has granted exemptive relief relating to leverage for BDCs with SBICs

• An SBIC subsidiary in certain instances may have to elect to be treated as a BDC and file with the SEC a registration statement on Form N-5
Volcker and BDCs
Covered Funds Prohibition

• General prohibition
  • A banking entity, as principal, may not directly or indirectly acquire or retain an ownership interest in, or sponsor, a covered fund

• The prohibition on acquiring or retaining ownership interests does not apply if
  • The banking entity acts solely as agent, broker or custodian for the account of, or on behalf of, a customer and does not have its own ownership interest
  • The banking entity’s ownership interest is held/controlled by it as trustee in connection with a deferred compensation or similar plan
  • The ownership interest is acquired and held in the ordinary course of collecting a debt
  • The banking entity holds the interest as a trustee or in a similar capacity solely for a customer that is not itself a covered fund
Scope of Prohibition

• A banking entity may not sponsor a covered fund, subject to certain exceptions

• Sponsorship means
  • To serve as a general partner, managing member, trustee or commodity pool operator (CPO) of a covered fund
  • To select or control selection of a majority of directors, trustees or management of a covered fund
  • To share with the covered fund the same name or a variation of the name
Scope of Prohibition (cont’d)

• A banking entity may not acquire/retain an ownership interest in a covered fund, subject to certain exceptions

• Ownership interest
  • Means any equity, partnership or “other similar interest”
  • “Other similar interest” is broadly defined to include
    • An interest in or security issued by a covered fund that exhibits certain characteristics on a current, future or contingency basis
    • The right to participate in the selection/removal of general partner, or managing member, director, investment manager or adviser (but not including typical creditor’s rights in the event of a default or acceleration)
    • The right to receive a share of income, gains or profits, or the underlying assets (e.g., the “residual” in a securitization)
    • Does not include “restricted profit interest” (carried interest)

• Ownership interest may include interests in a covered fund not considered an ownership or equity interest in other contexts
What Is Not a Covered Fund?

• Why does it matter if a fund is a covered fund?
  • If a fund is not a covered fund under these exclusions, the prohibitions on sponsorship and investment do not apply and prudential backstops and the need for a compliance program are not triggered

• Companies that do not meet the general definition of an “investment company”
  • Generally, a fund is an investment company if it is engaged or proposes to engage in the business of investing in securities that have a value exceeding 40% of the value of the company’s total assets (excluding cash and government securities)

• Funds that rely on an exception other than those found in Section 3(c)(1) or Section 3(c)(7) of the 1940 Act
What Is Not a Covered Fund? (cont’d)

- For a foreign banking entity (not controlled by a US banking entity), a foreign private fund may not be a covered fund under certain circumstances
- A foreign public fund
- Foreign funds that do not meet the specific conditions of this exclusion may not be covered funds for other reasons
Private Equity Interests

• For a BE that holds a direct interest in securities of a private company and intends to continue to hold such interest (or even add to its portfolio), it may wish to do so by holding the interest in a SBIC
  • A SBIC is not considered a covered fund
  • This may be most useful for those interests that a BE expects will mature
• A BE may want to hold its interests in a business development company (BDC)
  • A bank may hold an interest in a BDC. The BE likely would want to ensure that the BDC itself is not an “affiliate” of the BE (so that the BDC is not subject to Volcker Rule limitations)
  • The BE would own less than 25% of the BDC
  • Interests in the BDC could be offered and sold privately to institutional investors, such as hedge funds and pension funds
  • A registered investment adviser, which might be an affiliate of the BE, could serve as the adviser or manager of the BDC