Knowledge is power
A primer on private business development companies

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Cynthia M. Krus
Executive Partner

David A. Roby
Partner

Kristin H. Burns
Associate
Part I:
Overview of the BDC Model
# Types of BDC Structures

<table>
<thead>
<tr>
<th></th>
<th>Traded BDCs</th>
<th>Non-Traded BDCs</th>
<th>Private BDCs</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Type of Offering</strong></td>
<td>Traditional IPO</td>
<td>Continuous offering up to a preset maximum amount</td>
<td>Private placement offering; generally, a capital call structure</td>
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<tr>
<td><strong>Initial Portfolio</strong></td>
<td>Either a blind-pool vehicle or acquisition of an existing portfolio</td>
<td>Acquired as shares are sold</td>
<td>Acquired as capital is called</td>
</tr>
<tr>
<td><strong>Initial Liquidity</strong></td>
<td>Listed on NASDAQ or NYSE</td>
<td>Periodic repurchase offers</td>
<td>Generally none, but may conduct periodic repurchase offers</td>
</tr>
<tr>
<td><strong>Lifespan</strong></td>
<td>Indefinite</td>
<td>Generally contemplate an exchange listing within a fixed 5-7 year period</td>
<td>Generally contemplate either winding down or an IPO or other liquidity event within a fixed 5-7 year period</td>
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How the BDC Market Developed

- Prior to 2003, the largest BDCs were internally managed.
- In 2004, Apollo Investment Corporation raised $930 million in less than three months, which ignited the growth in the externally managed traded BDC industry.
- Franklin Square launched the first non-traded BDC in 2008.
- TPG launched the first private BDC in 2011.
- BDC assets aggregated approximately $90 billion through 2017.

# of new BDCs

![Bar chart showing the number of new BDCs from 2000 to 2017.](chart.png)
The BDC Industry Today

- **92 BDCs operating today**
  - **20 private BDCs** with aggregate assets of $7 billion
    - AB Private Credit Investors Corporation
    - TCG BDC II, Inc.
    - Crescent Capital BDC, Inc.
    - Flat Rock Capital Corp.
    - Goldman Sachs Private Middle Market Credit LLC
    - Goldman Sachs Middle Market Lending Corp.
    - Golub Capital Investment Corporation
    - Golub Capital BDC 3, Inc.
    - Hancock Park Corporate Income, Inc.
    - Owl Rock Capital Corporation
    - Parkview Capital Credit, Inc.
    - Runway Growth Credit Fund Inc. (fka GSV Growth Credit Fund Inc.)
    - Siguler Guff Small Business Credit Opportunities Fund, Inc.
    - TCW Direct Lending LLC
    - TCW Direct Lending VII LLC
    - Venture Lending & Leasing VII, Inc.
    - Venture Lending & Leasing VIII, Inc.
    - Venture Lending & Leasing IX, Inc.
  - **52 traded BDCs** with $33 billion aggregate market cap and $60 billion in assets
    - 3 traded BDCs began as private BDCs
      - TPG Specialty Lending, Inc.
      - Goldman Sachs BDC, Inc.
      - TCG BDC, Inc. (fka Carlyle GMS Finance, Inc.)
    - **19 non-traded BDCs** with aggregate assets of $23 billion
The BDC Industry Today (cont.)

Market Activity Since 2016

TCG BDC, Inc., the only traded BDC to IPO since 2016, began as a private BDC.
Part II:
Private BDC Overview
What is a Private BDC?

A Hybrid Between a Private Fund and a Traditional BDC

— Typically sponsored by large private equity firms with existing investor relationships
  • Shares are sold through a private placement offering
  • Shares are generally only sold to accredited investors
  • Capital generally drawn via a capital call model, similar to a private fund structure
  • Investors enter into a subscription agreement with the BDC

— May contemplate a liquidity event
  • Exchange listing or some other liquidity mechanism including, with proper relief and authorizations, a spin-off or merger

— BDC reporting, governance and investment limitations
  • Reporting required by the Exchange Act of 1934 (the 1934 Act)
  • Compliance with the Investment Company Act of 1940 (the 1940 Act)
Advantages of a Private BDC

- **Capital Commitment Structure**: Allows committed funds to be drawn as investment opportunities arise.

- **Optionality**: “Liquidity Events” may be determined in the future; fee structures may be different before and after a liquidity event.

- **Potentially Shorter Process**: Form 10 may be effective in as little as 60 days and no need for listing process.

- **Fewer Filings**: Private placement eliminates the obligation to complete the “blue sky” registration process faced by non-traded BDCs sold in a continuous offering.

- **Structuring Advantages**: BDC/RIC structure mitigates the need for an offshore feeder fund structure for foreign/tax-exempt investors.

- **No Withholding on Certain RIC Dividends**: Non-US investors not subject to US tax on interest-related, short-term capital gain, or long-term capital gain dividends.
Advantages of a Private BDC (cont.)

Tax Advantages of the Private BDC/RIC Structure

— Non-US investors are subject to:
  • US income tax income that is effectively connected with a US trade or business (ECI)
    • Must also have a permanent establishment if treaty applies
  • US withholding tax on dividends and interest (other than portfolio interest)

— Tax-exempt investors subject to unrelated business taxable income (UBTI)
  • Treated as having UBTI to extent purchased with debt financing

— Non-US investors and tax-exempt investors in private funds classified as partnerships are treated as engaging in any business of the partnership and tax-exempt investors treated as financing investments with debt to extent of partnership used debt to purchase investments
  • Private funds originating debt may be engaged in US trade or business and generally use leverage to purchase investments

— BDC/RIC generally acts as a corporate blocker for UBTI (including debt) and ECI

— No withholding tax on interest-related dividends, short-term capital gain dividends, or long-term capital dividends
Part III: Raising a Private BDC
Process to Raise a Private BDC

- Organize the entity
  - Typically a Delaware or a Maryland corporation

- File a registration statement on Form 10 to register a class of securities under the 1934 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
  - Sold only to accredited investors
Process to Raise a Private BDC (cont.)

— Seek approval for and enter into an advisory agreement
  • Advisory agreements must be approved by a majority of the board of directors, including a majority of the independent directors, at an in-person meeting
  • Advisory agreements must be approved in accordance with Section 15(c) of the 1940 Act

— Make an election to be regulated as a BDC by filing Form N-54A

— Comply with all other federal securities laws and regulatory requirements for a BDC, including:
  • 1940 Act
  • 1934 Act
  • Sarbanes-Oxley Act
Private Placement Process

- Placement activities may be conducted by officers of the BDC or its investment adviser or by a placement agent
  - Placement agent fees may be paid by the investors or the adviser

- Generally, all investors must be “accredited investors”

- Investors may include
  - High net worth individuals
  - Family offices
  - Foreign and U.S. Institutional investors
  - Pension plans

- Investors enter into a subscription agreement with the BDC

- Investors must comply with Section 13 and Section 16 filings requirements
  - Schedule 13D or 13G for beneficial ownership over 5%
  - Forms 3 and 4 for beneficial ownership over 10%
Capital Call Process

— Subscription agreement requires investors to make a capital commitment to purchase shares of the BDC

— BDC draws committed funds as investment opportunities arise
  • Drawdown notices are generally delivered to investors 10 days before capital is required to be funded
  • Upon receipt of a drawdown notice, investors purchase shares of the BDC for a purchase price equal to a recent net asset value per share
    • Within 48 hours (excluding Sundays and holidays) of the drawdown date, the BDC’s board of directors must determine that the purchase price per share is not below the BDC’s net asset value per share

— Investors making a subsequent capital commitment may be required to fund a “catch-up” drawdown
  • The catch-up drawdown ensures that all investors have contributed the same percentage of their capital commitment
  • The catch-up purchase price may be adjusted so that subsequent investors pay a *pro rata* portion of the BDC’s initial organizational expenses
Part IV:
Liquidity Events; Optionality
Potential Liquidity Events

- **Exchange Listing**
  - File Form N-2 to register shares under the Securities Act
  - List shares on a stock market
  - Requires board approval

- **Merger**
  - The private BDC merges into a public BDC
  - Requires a registration statement
  - Requires board and shareholder approval

- **Spin-Off**
  - The private BDC contributes assets to a new BDC and shares of the new BDC are distributed to the private BDC’s shareholders
  - Requires exemptive relief from the SEC
    - Relief from Sections 57(a)(1) and 57(a)(2) of the 1940 Act to allow the private BDC to transfer its assets to the New BDC while the private BDC and the New BDC are affiliated persons
    - Relief from Section 57(a)(4) and Rule 17d-1 of the 1940 Act to the extent the spin-off is considered a prohibited joint transaction
    - Relief from Sections 12(d)(1)(A) and 12(d)(1)(C) to allow the private BDC to 100% of the New BDC prior to the spin-off
  - Requires board and shareholder approval
  - Generally taxable
Optionality

— Advisory fee structure may be different before and after a liquidity event
  • Allows for a different advisory fee during the BDC’s ramp-up period
  • Prior to a liquidity event, the advisory fee may be lower or the adviser may not charge an incentive fee

— Fees paid to the independent members of the board of directors may be different before and after a liquidity event

— The board of directors decides which liquidity event is in the company’s best interest based on market and other conditions at the time
  • Following a liquidity event, disapproving shareholders generally have an opportunity to sell their shares

— It may be possible to structure liquidity events to give shareholders additional optionality
Part V:
Private BDC Boards
Private BDC Boards

- Must consist of a majority of independent directors, some of which may also serve on boards of other BDCs managed by the same adviser.
- Independent directors may be paid different fees before and after a liquidity event or be paid fees on a sliding scale based on assets.
- Significant investors may seek nomination rights.
- Obligations of a private BDC’s board are the same as those for a publicly traded BDC’s board.
Board Responsibilities

- **Independence**: A majority of the board must be independent
  - Determined by Section 2(a)(19) of the 1940 Act
  - Generally, the following are not independent: (1) affiliates and their family members; (2) interested persons of the Company’s adviser or principal underwriter; (3) the Company’s legal counsel or anyone who served as legal counsel within the last two years; (4) any person who has engaged in a transaction with or loaned money to the Company in the past six months; and (5) anyone who has a material business or professional relationship with the Company
  - Independent directors may serve on the board of multiple funds managed by the same adviser

- **Advisory Contract**: Approve advisory agreements
  - Advisory agreements must be approved at an in-person meeting of the Board
  - To approve an advisory agreement, a majority of the Board, including a majority of the independent directors must (1) request comprehensive information about the adviser’s services; (2) evaluate the services and the advisory fees paid for these services; and (3) decide whether to approve the advisory agreement

- **Compliance**: The Board must approve the Company’s compliance program and Chief Compliance Officer (CCO)

- **Valuation**: The Board must approve the Company’s valuations quarterly
Part VI: Regulatory Framework
SEC Reporting Requirements

- Form 10-K (Annual Report)
- Form 10-Q (Quarterly Report)
- Form 8-K (Current Report)
- Proxy Statements

- Section 13 and Section 16 Filings
  - Schedules 13D and 13G for reporting beneficial ownership by greater than 5% shareholders
  - Forms 3, 4 or 5 for reporting beneficial ownership by directors, executive officers and greater than 10% shareholders

- Regulation FD

- Comply with the Sarbanes-Oxley Act of 2002

- Internal Control over Financial Reporting/Attestation
  - JOBS Act provides that “emerging growth companies” may take advantage of reduced reporting obligations on internal controls

- Disclosure Controls and Procedures
Financial Statement Disclosures

- Quarterly valuation of assets required to be filed
- Fair value and Level 3 reconciliation tables
- Control investments, investments in affiliates vs. investment in non-affiliates
- Schedule of investments requires disclosure of, among other things:
  • Name and address of each portfolio investment
  • Details of each portfolio investment (e.g., interest rate, maturity date)
  • Non-income producing investments
  • Assets held in securitized vehicles
- Concentration – Geography and industry sectors
- Reg G reconciliation of non-GAAP financial measures
1940 Act Requirements

- BDC must have a majority of independent directors – persons who are not “interested persons” as defined in Section 2(a)(19) of the 1940 Act

- Custodian agreement
  - 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, or be subject to additional audit and operational procedures related to securities held in safekeeping

- Fidelity bond
  - Maintain a bond issued by a reputable fidelity insurance company, in an amount prescribed by the 1940 Act, to protect the BDC against larceny and embezzlement
  - Must cover each officer and employee with access to securities and funds of the BDC

- Code of ethics
  - Maintain and enforce standards of conduct with officers and directors of the BDC
  - Requires reporting of all securities holdings and transactions
1940 Act Requirements (cont.)

- 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
  - More than 5% of the value of its total assets in an investment company
  - More than an aggregate of 10% of its total assets in investment companies

- Restrictions on investment funds investing in a BDC
  - Neither a public (i.e., registered) or private investment fund may own more than 3% of the outstanding voting stock of a BDC

- Limitations on indemnification
  - 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

- Must make available significant managerial assistance to portfolio companies
1940 Act Requirements (cont.)

— Must appoint a Chief Compliance Officer

— Must maintain a compliance program compliant with 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
  • Review of these policies and procedures annually for their adequacy and the effectiveness of their implementation

— Compliance policies and procedures for the registered investment adviser under Rule 206(4)-7 of the Investment Advisers Act of 1940
  • Requires an investment adviser of a BDC to adopt and implement policies and procedures
  • Requires maintenance and enforcement of a code of ethics for adviser’s employees

— Subject to regular examinations by the SEC
Basic RIC Qualification Requirements

- **Minimum Distribution**: Must distribute each year at least 90% of investment company taxable income (i.e., net ordinary income and net realized short-term capital gains)
  - Must distribute each calendar year at least 98% of ordinary income and 98.2% of capital gains for the one-year period ended October 31 to avoid 4% excise tax
  - Most RICs distribute 100% of income and gains

- **Asset Diversification**: At the end of each quarter of the taxable year, must have:
  - At least 50% of total assets in “good RIC assets” (i.e., cash and cash equivalents, government securities, securities of other RICs, and other securities for which RIC holds no more than 5% of its total assets in securities of the issuer and no more than 10% of the voting stock)
  - No more than 25% of total assets may be invested in the securities of any one issuer or any 2 or more issuers controlled by the RIC (i.e., 20% of vote) and that are engaged in the same or similar trades or businesses
  - Special rules apply to prevent disqualification due to changes in market value

- **Source of Income**: 90% of gross income for each taxable year must consist of “good RIC income” (i.e., dividends, interest, gains from the sale of securities, and certain other related income)
  - Certain “fees” may qualify as good RIC income
  - May need to block equity interests in pass-through entities
Other Important Limitations

- BDCs are not permitted to sell shares below net asset value (NAV) without shareholder approval
  - Approval must be obtained annually
  - Markets have imposed limitations on how much a BDC can sell below NAV

- 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 to officers/employees
  - Issuance of stock options to independent directors

- Exemptive relief process may take from 6–18 months depending on complexity
  - Typically based on precedents
Timeline to Raise a Private BDC
(represents the fastest possible timeline)

**Weeks 1-2:** Form entity; draft PPM and Form 10

**Week 3:** File Form 10 with SEC

**Weeks 4-6:** Draft advisory agreement and third-party agreements; draft 1940 Act compliance documents; draft charter and bylaws; draft subscription agreement

**Weeks 7-8:** Receive and respond to initial SEC comments to Form 10; prepare for organizational board meeting

**Weeks 9-10:** Finalize all agreements and compliance documents; clear any remaining SEC comments to Form 10

**Week 11:** Form 10 automatically effective 60 days after initial filing (may withdraw and refile if necessary); file election to be a BDC; begin complying with all 1940 Act and 1934 Act requirements

**Week 12:** Begin accepting and closing on subscription agreements
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