Client Alert

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House Holds Hearings on Bill to Ease BDC Restrictions

By Jay G. Baris and Anna T. Pinedo

The Subcommittee on Capital Markets and Government Sponsored Enterprises of the House Financial Services Committee heard testimony on June 16, 2015 in support of proposed bills that would, among other things, increase the flexibility of business development companies (BDCs) to use leverage and expand the pool of accredited investors.

The hearings focused on a draft bill proposed by Rep. John M. Mulvaney (R-SC) called "The Small Business Credit Availability Act," (the "Bill"). The Bill builds on H.R. 1800, which the House of Representatives passed in 2014, but was never enacted into law.

Among other things, the Bill would:

- Increase the ability of BDCs to leverage their investments, by decreasing the asset coverage requirement to 150 percent from 200 percent. The increased leverage authority would take effect one year after approval by shareholders or the BDC's independent directors.
- Allow BDCs to issue multiple classes of preferred shares and eliminate the requirement that preferred shareholders must have board representation.
- Modernize the securities offering and communications framework for BDCs to bring them into parity with corporate issuers that file on Forms S-1 and S-3.
- Eliminate a prohibition for BDCs to own investment advisers.
- Increase the bucket for investment in securities that are not "eligible portfolio companies," provided that those investments are not private equity funds, hedge funds or collateralized loan obligations (CLOs).

Testimony chronicled the rapid growth of BDCs and their increasing role in providing financing to middle market companies. One witness noted that currently today there are 57 publicly-traded BDCs with an aggregate market capitalization of more than $45 billion and approximately $77 billion in assets. The witness said that the aggregate would place the entire BDC industry as the 30th largest bank in the country by assets.

Although over the years the Securities and Exchange Commission has modernized the communications and securities offering framework applicable to most issuers, including through Securities Offering Reform in 2005, BDCs currently are not entitled to rely on many of the safe harbors and accommodations available to corporate issuers. The antiquated offering framework applicable to BDCs is a significant impediment to capital formation, especially in light of the fact that BDCs frequently access the capital markets in order to continue to raise funds to deploy.

The Bill attempts to address many of these issues and establish parity for BDCs when it comes to offering related communications safe harbors (Rules 134, 163, 163A, 168 and 169 of the Securities Act), research safe harbors (Rules 138 and 139), use of free writing prospectuses (Rule 164 and Rule 433), ability to rely on access equals delivery (Rules 172 and 173), real "shelf registration" provisions and eligibility for "well known seasoned issuer" status. These much-needed changes to the Securities Act should not prove controversial given that they would not affect the availability of information to investors or have the effect of reducing disclosure requirements.

Another witness suggested that the SEC should move away from a definition of "accredited investor" based solely on strict financial criteria and take into consideration an investor's financial sophistication.

Rep. Mulvaney's proposed Bill can be found here.

Contact:

Jay G. Baris
(212) 468-8053
jbaris@mofo.com

Anna T. Pinedo
(212) 468-8179
apinedo@mofo.com

Kelley A. Howes
(212) 336-4064
khowes@mofo.com

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