

SEC Eases Regulations On Business Development Companies

By Tom Zanki

Law360 (April 8, 2020, 8:01 PM EDT) -- The Securities and Exchange Commission on Wednesday agreed to ease rules on business development companies and certain funds over the objection of a dissenting commissioner, who argued the agency is weakening investor protections amid market turbulence and a health crisis.

By a 3-1 vote with Commissioner Alison Herren Lee in opposition, the SEC approved registration rules for BDCs and other registered closed-end funds that already apply to public companies. The changes reflect mandates set by two congressional bills passed in 2018, namely the Small Business Credit Availability Act and the Economic, Growth Relief, and Consumer Protection Act.

BDCs are vehicles that raise capital in order to invest in small to midsize companies that lack access to public markets and traditional financing. Closed-end funds are investment funds that raise a fixed amount of capital once through an initial public offering and list on an exchange.

The new rules would purportedly enable sponsors of eligible funds to raise capital more quickly and communicate with investors, putting them in a better position to take advantage of market opportunities. SEC Chairman Jay Clayton said the rule amendments will “benefit both investors in these funds and the companies in which they invest.”

“It is my hope, particularly when many of our small and medium sized businesses are facing profound challenges not of their own making, that these and other modernization efforts will provide those businesses more efficient access to financing,” Clayton said.

Lee questioned the timing of Wednesday’s action, saying the commission should focus on immediate market needs relating to volatility caused by the coronavirus pandemic.

“These rules stem from a proposal published over a year ago, and do not address conditions stemming from the COVID-19 crisis,” said Lee, currently the lone Democratic appointee on the commission. “Moreover, we choose this moment to weaken protections for retail investors.”

The new rules will allow eligible funds to sell securities after filing a “shelf” registration statement, providing them the flexibility to raise money at a later time when markets are favorable. Entities would be eligible if they meet certain filing and reporting history requirements and have a public float of at least \$75 million. Public companies already use shelf registrations.

The rules also allow eligible funds to qualify as “well known seasoned issuers” — or WKSIs — a designation that provides large public companies more flexible registration processes and ability to communicate with investors as long as they have at least \$700 million in market float and meet other requirements. Eligible funds will also be able to communicate with investors through a tool known as a “free writing prospectus,” which the SEC says will reduce regulatory costs.

Lee objected to the new rules on grounds that they omitted a requirement, which was included in the original proposal, that would have required closed-end funds to provide investors with updated disclosures known as 8-K filings when warranted. The final rules also dropped requirements that BDCs and funds should file 8-K reports in the event of a change in investment strategy or a material write-down of a significant investment.

“It is a fairly straightforward proposition that investors need timely information about material events, such as a material write-down of a significant investment, and the market volatility brought on by the current public health crisis brings this logic into sharp focus,” Lee said.

The rules take effect on August 1, 2020. Commissioners Hester Peirce and Elad Roisman supported the measure. Despite the coronavirus pandemic, Roisman said the SEC should move forward on fulfilling statutory mandates and taking regulatory actions when it can for the benefit of retail and institutional investors and other market participants.

“Blanket inaction would do a disservice to these stakeholders as well as the commenters who took the time to share their views with us over the past several weeks and months,” Roisman said.

Mayer Brown LLP partner Anna Pinedo endorsed Wednesday’s action, which put BDCs on a more level playing field with operating companies. She said the new rules will allow BDCs to “benefit from the same communications safe harbors that operating companies benefit from.”

“As BDCs have become increasingly larger, and more significant as alternative sources of capital, access to capital formation has been less efficient as a result of many impediments that will now be removed,” Pinedo told Law360.

--Editing by Amy Rowe.