

Legal Update

Proposed Securities Offering and Communications Reforms for BDCs and Closed-End Funds

Late last week, the Securities and Exchange Commission (SEC) proposed rule amendments that are intended to modernize the offering related provisions of the Securities Act of 1933 (the Securities Act) and the communications safe harbors available to business development companies (BDCs) and closed-end funds (CEFs) in order to harmonize these with the provisions applicable to operating companies.¹ The SEC also proposed accompanying amendments to Form N-2.² The SEC was required to undertake rulemaking with respect to BDCs by the Small Business Credit Availability Act,³ and to undertake rulemaking with respect to CEFs by the Economic Growth, Regulatory Relief and Consumer Protection Act, often referred to as the Crapo Act. Pursuant to the provisions of the Small Business Credit Availability Act, certain amendments became self-effectuating on the Act's one-year anniversary, which has now passed; however, BDCs may want to consider whether to rely on those provisions, or await SEC Staff guidance regarding the transition period since the proposed amendments address the same matters.

Among the most important proposed changes for BDCs and CEFs would be: the ability to qualify as well-known seasoned issuers

(WKSIs) to the extent that the entities meet the reporting history and float requirements; to benefit as WKSIs from the ability to engage in certain communications and rely on expedited shelf registration provisions; the ability for other BDCs and CEFs to use more streamlined shelf registration statement procedures; and the ability to rely on a number of important communications safe harbors.

Background

These proposed amendments are welcome given that historically the offering process for these entities has been cumbersome and has affected access to capital formation. For example, a public BDC must offer its securities pursuant to a registration statement on Form N-2. Following its initial public offering, a BDC that lists a class of common equity securities on a national securities exchange will become subject to the reporting requirements under the Securities Exchange Act of 1934 (Exchange Act). The Form N-2 registration statement did not contemplate its use as a "shelf" registration statement for continuous or delayed securities offerings. However, through no-action letter guidance, the SEC Staff has made a registration statement on

Form N-2 available for use as a shelf registration statement to the extent that a BDC has been an Exchange Act-reporting company for at least twelve months and meets the other eligibility requirements for a primary offering on a registration statement on Form S-3 (and similar relief has also been provided for CEFs). However, unlike registration statements on Form S-3 that allow incorporation by reference of information included in an issuer's Exchange Act filings to satisfy disclosure requirements in a registration statement, a registration statement on Form N-2 must be amended to update the registration statement with current information. BDCs and CEFs are also subject to certain limitations relating to their use of the registration statement on Form N-2 as a shelf registration for delayed offerings.

Historically, under the Securities Act BDCs and CEFs generally were not treated like operating companies. In 2005, as part of Securities Offering Reform, the SEC made significant changes to the provisions of the Securities Act. Securities Offering Reform identified certain categories of issuers, including seasoned issuers and WKSIs, that are eligible to use a broader array of offering-related communications, such as free writing prospectuses. The SEC also introduced the concept of automatic shelf registration for WKSIs. The Reform also introduced a number of communications safe harbors, providing greater certainty for issuers to engage in a broader range of communications without having such communications be considered "offers" under the Securities Act. Finally, the Reform introduced the concept of access equals delivery as a means of satisfying prospectus delivery requirements under the securities laws. While all of these changes facilitated capital formation for operating companies, and especially for WKSIs, the SEC did not extend these accommodations to BDCs or CEFs.

As mentioned earlier, the SEC was required to undertake rulemaking by the Small Business Credit Availability Act, which in addition to amending the asset coverage requirements applicable to BDCs, also required that within one year of enactment, the SEC amend its offering and communications rules applicable to BDCs. The Economic Growth, Regulatory Relief and Consumer Protection Act included Section 509, titled Parity for Closed-End Companies Regarding Offering and Proxy Rules (the "Parity Act"). The Parity Act requires that within one year of enactment, the SEC propose, and no later than two years following enactment, the SEC adopt, final rules that extend to CEFs the securities offering and proxy rules available to operating companies under the Securities Act.

Proposed Amendments

Below we summarize a few of the principal amendments, which are included in the proposing release.

WKSI STATUS

A BDC or CEF will no longer be considered an "ineligible issuer" and, as a result, will be able to use free writing prospectuses. As a result a BDC or CEF also will be able to qualify as a WKSI and file an automatically effective shelf registration statement on Form N-2 and avail itself of other benefits to which WKSIs are entitled. Many BDCs and CEFs have the common equity market value necessary to meet the WKSI criteria. For these entities, once the amendments become effective, raising capital will become much more efficient.

FORM N-2, INCORPORATION BY REFERENCE AND RULE 424

Form N-2 will be amended to allow for incorporation by reference in the same manner as Form S-3. Rule 415 also will be amended to make it applicable to offerings made pursuant to Form N-2 by issuers that

meet the eligibility requirements for use of a registration statement on Form S-3. In the case of a CEF, in addition to meeting the eligibility requirements for use of Form S-3 in order to incorporate by reference, the CEF must have been registered under the Investment Company Act of 1940 (Investment Company Act) for at least 12 months preceding the filing of the registration statement and also be current in its 1940 Act filings (e.g., Forms N-CEN and N-PORT) during that period. A BDC or CEF that meets the Form S-3 eligibility requirements would be able to backward incorporate and forward incorporate subsequently filed Exchange Act documents. However, a CEF would not be permitted to incorporate by reference Forms N-CEN or N-PORT. Issuers meeting the Form S-3 eligibility requirements also will be able to rely on Rule 430B in order to omit certain information from their registration statements and rely on the prospectus to provide the omitted information.

Rule 497 will be amended to allow BDCs and CEFs to file form prospectus supplements in a process resembling that available to operating companies relying on Rule 424. As a result, a fund that is a WKSJ will be able to file an automatically effective shelf registration statement, benefit from satisfying disclosure requirements through incorporation by reference, and access the markets as opportunities present themselves, without having to wait for the SEC Staff to review and approve a new or a post-effective registration statement.

BDCs and CEFs that meet certain criteria also would be able to incorporate by reference information on their proxy statements relating to the authorization or issuance of any securities otherwise than for exchange, as well as information relating to the modification of any class of securities or the issuance or authorization for issuance of securities of the

registrant in exchange for outstanding securities.

ACCESS EQUALS DELIVERY

Rules 172 and 173, which permit “access equals delivery,” will be applicable to BDCs and CEFs. The prospectus and statement of additional information and incorporated materials would be required to be made available on a website. This will eliminate the outdated process of having to print prospectuses and deliver physical copies of prospectuses to investors in BDC and CEF offerings.

COMMUNICATIONS RULES

BDCs and CEFs will also be able to rely on various communications safe harbors under the Securities Act. BDCs and CEFs will be able to rely on Rules 168 and 169 under the Securities Act, which allow Exchange Act-reporting and non-reporting companies to disseminate regularly released factual business and forward-looking information even around the time of a securities offering without having such information be considered an “offer,” so long as no reference is made to any potential offering. BDCs and CEFs will be able to rely on the safe harbors under Rules 134, 163A and 163. Rule 134 provides a safe harbor that allows issuers to make certain written statements regarding an offer after a prospectus is filed, provided certain conditions are met. Rule 163A provides a safe harbor from the Section 5(c) prohibition on pre-filing offers for communications that do not reference an offering, and that are made more than 30 days prior to the filing of a registration statement, provided certain conditions are met. Rule 163 provides a safe harbor from the Section 5(c) prohibition on pre-filing offers for WKSJs to engage in unrestricted oral and written communications before the filing of a registration statement, if certain conditions are met.

The Small Credit Availability Act would have required the SEC to amend the research safe harbors provided by Rule 138 and Rule 139, which provide that certain reports are not considered offers under the Securities Act, to make these applicable to BDCs. The proposing release would amend Rule 138, which permits a broker-dealer participating in a securities offering to publish research reports about that issuer, if certain conditions are met. Rule 139 permits a broker-dealer participating in the distribution of securities of an issuer to publish research reports concerning that issuer or any class of its securities, if certain conditions are met. As a result of the rule-making mandate contained in the Fair Access to Investment Research Act of 2017, the adoption of which preceded the enactment of the Small Business Credit Availability Act, the SEC had to provide a safe harbor for research reports that relate to certain registered investment companies, including exchange-traded funds, BDCs, CEFs, and exchange-traded commodity-based or currency-based trusts or funds. The SEC recently adopted a new safe harbor, Rule 139b, which, generally, meets the requirements of the Small Business Credit Availability Act and the Parity Act.⁴

Other Proposed Amendments

The proposing release sets out a number of additional amendments that were not contemplated by either the Small Business Credit Availability Act or the Parity Act. We summarize these briefly below:

CEFs would become subject to a Form 8-K requirement (as BDCs currently are), and would expand the mandatory Form 8-K filing requirements to include an obligation to report a material change to a fund's investment objective or policy that was not or will not be submitted to stockholders for their approval unless already disclosed in a post-effective amendment to a registration

statement or to a prospectus filed pursuant to Rule 424; and any material write-down in the fair value of a significant investment. These Form 8-K requirements are proposed to be phased in for those funds that do not rely on a short-form registration statement on Form N-2.

BDCs and CEFs that meet the Form S-3 eligibility requirements and that file short-form registration statements would be required to include additional information in their annual reports.

BDCs would be required to submit financial statement information in registration statements and Exchange Act reports using Inline XBRL, and BDCs and CEFs would be required to tag certain data on the cover page of Form N-2 using Inline XBRL format, as well as be required to tag certain disclosures in their prospectuses and Form S-3 eligible funds would be required to tag certain information in their Exchange Act reports.

Conclusion

The proposed amendments are subject to a 60-day public comment period following publication in the Federal Register. We have included for reference the summary table provided in the SEC's proposing release below.

Endnotes

¹ See the proposing release: <https://goo.gl/XFyUfY>.

² See: <https://goo.gl/Uh1q9L>.

³ See our Legal Update relating to the Small Business Credit Availability Act here: <https://goo.gl/pc1GFK>, and a chart summarizing the changes required by the Act here <https://goo.gl/dSHBz7>.

⁴ See our Legal Update relating to Rule 139b here: <https://goo.gl/HzH5p3>.

TABLE 1 (from SEC proposing release)

Rule	Summary Description of Rule	Entities Affected by Proposed Changes
REGISTRATION PROVISIONS		
Securities Act Rule 415	Permits registration of securities to be offered on a delayed or a continuous basis.	Seasoned Funds*
Proposed General Instructions A.2 and F.3 of Form N-2	Provide for backward and forward incorporation by reference.	Seasoned Funds
Proposed General Instruction F.4.a	Requires online posting of information incorporated by reference.	Affected Funds
Securities Act Rule 430B	Permits certain issuers to omit certain information from their “base” prospectuses and update the registration statement after effectiveness.	Seasoned Funds
Securities Act Rule 462	Provides for effectiveness of registration statements immediately upon filing with the Commission.	WKSIs
Securities Act Rule 418	Exempts some registrants from an obligation to furnish certain engineering, management, or similar reports.	Seasoned Funds
Investment Company Act Rule 22c-3	Subjects interval funds to the registration fee payment system based on annual net sales.	Interval Funds
COMMUNICATIONS PROVISIONS		
Securities Act Rule 134	Permits issuers to publish factual information about the issuer or the offering, including “tombstone ads.”	Affected Funds
Securities Act Rule 163A	Permits issuers to communicate without risk of violating the gun-jumping provisions until 30 days prior to filing a registration statement.	Affected Funds
Securities Act Rules 168 and 169	Permit the publication and dissemination of regularly released factual and forward-looking information.	Affected Funds

Rule	Summary Description of Rule	Entities Affected by Proposed Changes
Securities Act Rules 164 and 433	Permit use of a "free writing prospectus."	Affected Funds
Securities Act Rule 163	Permits oral and written communications by WKSIs at any time.	WKSIs
Securities Act Rule 138	Permits a broker or dealer to publish or distribute certain research about securities other than those they are distributing.	Seasoned Funds
PROXY STATEMENT PROVISION		
Item 13 of Schedule 14A	Permits certain registrants to use incorporation by reference to provide information that otherwise must be furnished with certain types of proxy statements.	Seasoned Funds
PROSPECTUS DELIVERY PROVISIONS		
Securities Act Rules 172 and 173	Permit issuers, brokers, and dealers to satisfy final prospectus delivery obligations if certain conditions are satisfied.	Affected Funds
STRUCTURED DATA REPORTING PROVISIONS		
Structured Financial Statement Data	A requirement that BDCs tag their financial statements using Inline eXtensible Business Reporting Language ("Inline XBRL") format.	BDCs
Prospectus Structured Data Requirements	A requirement that registrants tag certain information required by Form N-2 using Inline XBRL.	Affected Funds
Form 24F-2 Structured Format	A requirement that filings on Form 24F-2 be submitted in a structured format.	Form 24F-2 Filers
PERIODIC REPORTING PROVISIONS		
Investment Company Act Rule 8b-16	A requirement that funds that rely on the rule disclose certain enumerated changes in the annual report in enough detail to allow investors to understand each change and how it may affect the fund	Registered CEFs
Proposed Item 24.4.h(2) of Form N-2	A requirement for information about the investor's costs and expenses in the registrant's annual report.	Seasoned Funds

Rule	Summary Description of Rule	Entities Affected by Proposed Changes
Proposed Item 24.4.h(3) of Form N-2	A requirement for information about the share price of the registrant's stock and any premium or discount in the registrant's annual report.	Seasoned Funds
Proposed Item 24.4.h(1) of Form N-2	A requirement for information about each of a fund's classes of senior securities in the registrant's annual report.	Seasoned Funds
Proposed Item 24.4.g of Form N-2	A requirement for narrative disclosure about the fund's performance in the fund's annual report.	Registered CEFs
Item 4 of Form N-2	Requires disclosure of certain financial information.	BDCs
Proposed Item 24.4.h(4) of Form N-2	A requirement to disclose outstanding material staff comments that remain unresolved for a substantial period of time.	Seasoned Funds
CURRENT REPORT PROVISIONS		
Exchange Act Rules 13a-11 and 15d-11	Require registered CEFs to file current reports on Form 8-K.	Registered CEFs
Proposed Section 10 of Form 8-K	Requires current reporting of two new events specific to affected funds.	Affected Funds
Regulation FD Rule 103	Provides that a failure to make a public disclosure required solely by rule 100 of Regulation FD will not disqualify a "seasoned" issuer from use of certain forms.	Seasoned Funds

*Some of the proposed rule changes that are shown above as affecting "seasoned funds" would only affect those seasoned funds that elect to file a registration statement on Form N-2 using a proposed instruction permitting funds to use the form to file a short-form registration statement.

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