



Shelf Offerings by Business Development Companies

Business development companies (“BDCs”) are companies that invest primarily in the securities of private and smaller public companies and that elect to be registered under the Investment Company Act of 1940, as amended (the “1940 Act”). Historically, BDCs have faced challenges raising capital due to regulatory constraints imposed by the 1940 Act. BDCs generally cannot issue and sell shares of their common stock at a price below their net asset value (“NAV”) unless the issuing BDC receives prior approval from its shareholders to do so. The common stock of BDCs frequently trades below NAV. Further, the 1940 Act imposes a number of additional restrictions on the issuance of debt, preferred and other senior securities by BDCs. In particular, the issuance of a debt, preferred or senior security typically requires the issuing BDC to maintain an asset coverage of at least 200% (or 150% for electing BDCs as described below), generally limiting the BDC’s ability to incur leverage.

In addition, until quite recently as described below, BDCs were treated under the Securities Act of 1933, as amended (the “Securities Act”), differently from other operating companies and not able to rely on many of the offering and communications related accommodations or safe harbors available to operating companies generally.

Larger BDCs generally prepare and file a registration statement with the Securities and Exchange Commission (the “SEC”) and structure that registration statement as a “shelf” in order to access the capital markets when their common stock trades above NAV. A shelf registration statement can be filed with the SEC to register offerings of a BDC’s securities at a time when the BDC does not have an immediate intention to sell its securities. The typical SEC review process for an initial shelf registration statement takes approximately 30 to 45 days from the initial filing. The shelf registration statement allows the BDC to register multiple future offerings of its securities. Shelf registration statements are also especially useful for BDCs that trade at a premium to NAV for short and often unpredictable periods of time. When the BDC offers securities pursuant to an effective shelf registration statement, the BDC may take the securities “off the shelf” generally without waiting for any additional SEC staff review.

Small Business Credit Availability Act

The Small Business Credit Availability Act (the “SBCAA”) reduced the asset coverage requirement applicable to electing BDCs from 200% to 150%. This reduction allows electing BDCs to maintain a maximum 2:1 debt-to-equity leverage ratio. Increasing the leverage limit allows BDCs to deploy additional (possibly lower-risk senior) capital to borrowers and potentially increase their total returns without needing to deploy higher-risk junior capital in order to obtain higher yields. In order to elect to reduce the asset coverage requirement, the SBCAA requires that either one of the following be true:

- a majority of the BDC’s board of directors and a majority of its disinterested directors (as defined under the 1940 Act) approve the modified asset coverage ratio, which effectiveness would be delayed one year following the approval; or
- a majority of the BDC’s shareholders approve the decreased asset coverage ratio, which would be immediately effective following the approval.

In either scenario, a BDC that opts to rely on the reduced asset coverage requirement must publicly disclose within five business days its election to do so and provide the market with the BDC’s existing leverage ratio and risks associated with increasing the leverage ratio. Further, a BDC that does not have its securities trade on a national securities exchange is required to offer its stockholders an opportunity to have their shares repurchased by the BDC following the approval to increase the leverage ratio.

The SBCAA also required the SEC to implement amendments to various rules and regulations under the Securities Act in order to provide parity for BDCs in relation to their operating company peers with respect to securities offerings, offering-related communications, and research safe harbors. As a result, the SEC adopted the following rules:

- BDCs are now able to qualify as well-known seasoned issuers (“WKSIs”) and avail themselves of other benefits to which

WKSIs are entitled. WKSIs are able to file automatically effective registration statements, avoiding delays in connection with SEC reviews and enabling these issuers to access the capital markets quickly. A WSKI also is able to use a free writing prospectus before the filing of a registration statement and may engage in certain pre-filing communications.

- Like operating companies, BDCs are now able to engage in a streamlined registration process to sell securities “off the shelf” more quickly and efficiently through the use of a new short-form registration statement so long as the BDC meets certain filing and reporting history requirements and has a public float of \$75 million or more.
- Rules 172 and 173, which permit “access equals delivery,” are now applicable to BDCs. The prospectus and incorporated materials must be made available on a website, thereby eliminating the requirement to print prospectuses and deliver physical copies of prospectuses to investors in BDC offerings.
- BDCs may now incorporate by reference (backwards and forwards) in their registration statements from other filings, generally eliminating the requirement to file post-effective amendments to their registration statements in order to bring current their disclosures. BDCs are also now able to file a form of prospectus and a final prospectus under amended Rule 497 of the Securities Act.
- BDCs are now permitted to rely on communications-related safe harbors available to operating companies. These communication safe harbors include the ability (i) to make certain offering communications prior to the declaration of an effective registration statement, (ii) to have broker-dealers issue regularly published research reports about BDCs, and (iii) to release factual business information.

These changes are likely to reduce operating costs for BDCs and allow BDCs to access capital more efficiently.

Shelf Registration Statement Eligibility Requirements

BDCs use a registration statement on Form N-2 in order to register securities for an offering to be made on an immediate, continuous or delayed basis pursuant to Rule 415 under the Securities Act. In order to be eligible to file a shelf registration statement, the BDC must:

- be organized or incorporated under the laws of the United States or any state or territory or the District of Columbia and have its principal business operations in the United States or its territories;
- have a class of securities that is required to be registered pursuant to Section 12(b) or 12(g) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), or be subject to the reporting requirements of Section 15(d) of the Exchange Act;
- have filed all reports and other materials required by the SEC pursuant to Section 13, 14 or 15(d) of the Exchange Act for a period of at least 12 calendar months prior to the shelf registration statement filing;
- not have (i) failed to pay any dividend or sinking fund installment on preferred stock or (ii) defaulted on any installment for indebtedness for borrowed money or on any rental on long-term leases, in each case, since its last fiscal year-end; and
- have an aggregate market value of voting and non-voting common equity held by non-affiliates of at least \$75 million.

BDC Follow-On Offerings

Pursuant to the shelf registration process, a BDC may offer up to a specified maximum aggregate amount of its registered securities. The securities registered may include common stock, preferred stock, warrants (representing rights to purchase shares of common stock), debt securities or subscription rights, on terms to be determined at the time of the offering.

BDCs issue debt securities from time to time, either in “follow-on” offerings or “takedowns” from a medium-term note program. Medium-term note programs allow BDCs to offer debt securities to large institutional investors on a continuous basis. BDCs also frequently list their debt securities on a national securities exchange in “baby bond” offerings. Equity securities are issued by BDCs from time to time, either in follow-on offerings or in “at-the-market” (“ATM”) offerings as described in more detail below.



In addition to issuing debt and equity securities, BDCs may also issue rights that convert into voting securities even when its common stock is trading below NAV, subject to certain limitations. In a rights offering, a BDC's existing shareholders may purchase, on a pro rata basis, newly issued shares of the BDC's common stock at a price typically set at a significant discount to the market price of the common stock. A rights offering may be a useful way for a BDC to raise capital while avoiding shareholder approval requirements.

At-the-Market Offerings by BDCs

An ATM offering is an offering of securities into the existing trading market for such securities at other than a fixed price (i) on, or through the facilities of, a national securities exchange or (ii) to or through a market-maker. Therefore, the price at which securities are sold in an ATM offering will vary because it is based on the price at which the securities trade. Through an ATM or equity distribution program, a BDC may conduct ATM offerings from time to time to or through a broker-dealer acting either on a principal or agency basis. Each ATM offering is structured as a takedown from the related shelf registration statement.

The BDC can either (i) use an allocated portion of an already existing shelf registration statement specifically for ATM offerings or (ii) prepare a new shelf registration statement specifically for ATM offerings. If the BDC issuer decides to use an already existing shelf registration statement, then the BDC must prepare a prospectus supplement specifically for the ATM program. At the time the ATM offering commences, the BDC will file a prospectus supplement (pursuant to amended Rule 497 under the Securities Act) that discloses the terms of the offering, including the name of the sales agent. However, as discussed above, BDCs may now automatically incorporate by reference other filings in their registration statements. These reforms generally eliminate the requirement for BDCs to file post-effective amendments to their registration statements in order to bring current their disclosures thereby allowing BDCs to refresh ATM programs in a more cost-efficient manner. Note that for BDCs, the equity distribution agreement is subject to the requirements of Section 15(c) of the 1940 Act and must be approved at an in-person board meeting called for the purpose of voting on the agreement by a majority of the BDC's directors who are not interested parties.

Shelf Takedowns When Offering Prices Are Below NAV

As explained above, a BDC's ability to raise capital is limited when its common stock price is below NAV. When a BDC wants to issue or sell shares of its common stock at a discount to its NAV, the BDC must obtain shareholder approval in advance. Shareholder approval is required because of the potentially dilutive impact of selling shares below NAV. As a result, the BDC's board of directors or another authorized committee must determine that the BDC is not selling shares of its common stock at a price below NAV at the time the sale is made. In the context of an offering of common stock made pursuant to a shelf registration statement, the BDC's board of directors typically considers the following factors, among others, in making its determination:

- the NAV that the BDC disclosed in its most recent periodic report filed with the SEC;
- management's assessment of whether any material change in the BDC's NAV has occurred within the period between the date of the BDC's most recently disclosed NAV and a date two days prior to the proposed sale of the BDC's common stock; and
- the magnitude of the difference between (i) a value that the BDC's board of directors has determined reflects the BDC's current NAV. This value is based on the NAV that the BDC disclosed in its most recent SEC periodic report filing and is adjusted to reflect management's assessment of any material change in the NAV since the date the BDC most recently disclosed its current NAV and (ii) the current offering price of the BDC's common stock.

The SEC generally limits the cumulative dilution to a BDC's current NAV per share that a BDC may incur while using a shelf registration statement to sell shares of common stock at a price below NAV. A BDC can complete multiple offerings off of an effective shelf registration statement only to the extent that the cumulative dilution to the BDC's NAV per share does not exceed 15%. Once the cumulative dilution exceeds 15%, the BDC must file a post-effective amendment to the shelf registration statement or file a new shelf registration statement.



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On point.

