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"The Private BDC" Alternative

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REGULATORY OVERVIEW OF BDCs

Regulatory Overview of BDCs

Summary

- Created by the Small Business Investment Incentive Act of 1980 as a result of a perceived crisis in the capital markets in the 1970s.
- Special type of closed-end fund designed to provide small, growing companies access to capital, while also enabling private equity funds to access the public capital markets.
- Hybrid between an operating company and an investment company.
  - Regulated as an investment company, but to a lesser extent as provided by Sections 55-65 of 1940 Act
  - Required to file periodic reports under the Securities Exchange Act like operating companies (i.e., Forms 10-K, 10-Q and 8-K and proxy statements)
- BDCs generally elect to be taxed as Regulated Investment Companies (RICs)

Regulatory Overview of BDCs

<u>Brief Overview of Regulatory Requirements</u>

- Must offer to provide managerial assistance to portfolio companies;
- Must have majority-independent board of directors;
- Must value assets at least quarterly;
- Must maintain 200% asset coverage ratio;
- Must appoint a chief compliance officer (who reports to the board) and maintain compliance procedures designed to prevent violations of federal securities laws;
- Must adopt a code of ethics that requires reporting requirements of investment personnel;
- Must maintain a fidelity bond to protect the BDC against larceny and embezzlement;
- Securities and cash must be held by custodian that meets requirements under the 1940 Act; and
- All BDCs and their investment advisers subject to regulatory exams by the SEC.

Regulatory Overview of BDCs

Regulations of BDCs vs. other investment companies

- *Character of Investments* – Must generally invest at least 70% of total assets in "qualifying assets" pursuant to Section 55(a) of the 1940 Act
  - Generally requires investments in "eligible portfolio companies" which are private U.S. companies or U.S. companies with market cap of not greater than $250 million
  - Other categories of investment companies are not subject to these requirements
- *Leverage* – Must maintain 200% asset coverage ratio (1:1 assets to leverage) as opposed to 300% asset coverage ratio for other investment companies
  - BDCs formed after March 2018, as well as pre-existing BDCs that obtained board/stockholder approval and took other required steps, subject to reduced asset coverage ratio of 150% (1:2 assets to leverage)

Regulatory Overview of BDCs

- *Affiliated Transactions* – BDCs, like other investment companies, are subject to restrictions on transaction with affiliates, but restrictions on BDCs are less onerous than restrictions on other investment companies
  - In order to co-invest with an affiliate, must obtain exemptive relief from the Division of Investment Management or invest in transactions where price is the only negotiated item (such as syndicated loans)
  - Independent directors of BDCs able to approve certain affiliated transactions with second-tier affiliates
- *Adviser Compensation* – Investment advisers to BDCs are able to receive capital gains incentive fees in an amount not to exceed 20% of realized capital gains
  - Investment advisers to other investment companies generally prohibited from receiving capital gains incentive fees

BDC STRUCTURES
NON-TRADED, TRADED AND PRIVATE

Non-Traded BDCs

- FS Investment Corporation launched the first publicly-registered, non-traded BDC in January 2009.
- From 2010 – 2014, fundraising for non-traded BDCs saw tremendous increases, but subsequent years have seen sharp declines, consistent with declines experienced by non-traded REITs and similar products.
- Aggregate fundraising by non-traded BDCs peaked in 2014, when approximately $5.5 billion was raised.

Non-Traded BDCs

- Reasons for decline in fundraising include:
  - FINRA rules which require that net asset value (which reflects high up-front sales load) appears on customer account statements;
  - To date, SEC has not permitted BDCs to offer multiple share classes;
  - Uncertainty regarding the Department of Labor fiduciary standard and the subsequent Regulation Best Interest;
  - Performance of selected BDCs; and
  - External negative events in the non-traded REIT/BDC industry.
- Result is that there are currently very few non-traded BDCs raising capital.

Listed BDCs

- Currently, there are approximately 50 BDCs whose shares are listed on a national securities exchange ("listed BDCs"). Of this amount, less than half have total assets in excess of $1 billion.
- The table below shows the number of firm commitment IPOs of BDCs during the years 2013-2018. In the years 2010-2012, there were a total of 15 BDC IPOs.

Year	Number of IPOs	Names
2013	4	Capitala, Oaktree, Harvest, Garrison
2014	5	Alcentra, FSIC, TPG, TriplePoint, CM Finance
2015	1	Goldman Sachs BDC
2016	1	Great Elm Capital
2017	1	TCG BDC
2018	1	Bain Capital

Evolution to “Private BDC” Structure

- Combine the low number of new BDC sponsors able to complete an IPO with the difficulties associated with raising capital from retail investors in non-traded BDCs, and sponsors have sought out alternative avenues to raise capital.
- In recent years, this has led to the formation of so-called “private BDCs,” which are BDCs that conduct private offerings to accredited and institutional investors. By selling to accredited and institutional investors, private BDCs are able to raise capital in the same manner as private equity funds – through capital commitments and drawdowns.

BDC Structures

- From 2013 through May 2019, a total of 57 N-54As[1] were filed by entities electing to be regulated as BDCs, over half of which were filed by private BDCs. The breakout is below:

Type	Number
Private BDCs (Form 10 filings)	30
Non-Traded BDCs	15
Listed IPOs	9
Mergers	3
	57

[1]A Form N-54A is filed in order to formally elect to be regulated as a BDC. Number reflects the total number of entities that operated as BDCs following such election.

Private BDCs – What Are They?

- What is the difference between a private BDC and a non-traded or listed BDC?

	Private BDC	Non-Traded BDC	Listed BDC
Manner of Offering Shares	Private, continuous offering to “Accredited Investors” under Reg. D	Public, continuous offering registered under the 1933 Act	Public offering registered under the 1933 Act
Way of Receiving Capital	Typically commitment/drawdown structure	Investments fully-funded at periodic closings	Investments fully-funded at IPO
SEC filings	Form 10 with automatic effectiveness following SEC review	Form N-2 that is declared effective	Form N-2 that is declared effective
Exchange Act Reporting Required?	Yes	Yes	Yes
Liquidity Event	Merger, liquidation or distribution of assets upon maturity of portfolio	Merger, liquidation or distribution of assets upon maturity of portfolio	N/A
State “Blue Sky” Registration or Qualification Requirements	Notice only in individual states and territories where shares are offered and sold	Subject to review and qualification by individual states and territories where shares are offered and sold	N/A

Private BDCs – Who May Benefit?

- Who may benefit from private BDC structure?
  - This structure may be appealing to a private equity firm or other asset manager that has ready access to an existing base of accredited investors with whom the firm has a pre-existing relationship.
  - This structure may also be appealing to a start-up asset manager that is looking to create a public track record without having to bear the costs associated with a non-traded public offering or is unable to enlist the services of an investment bank to do an IPO.
    - Further, entities that are BDCs or intend to elect to be regulated as BDCs are not eligible to conduct a "mini IPO" under Regulation A+.

Private BDCs – Who May Benefit?

- Who may benefit from private BDC structure? (Continued)
  - Unlike non-traded BDCs, the drawdown structure permits BDCs to be selective and nimble with cash deployment to align it with availability of suitable investment opportunities, although there is a risk of defaulting investors and complexities involved as to how they are treated.
  - Private BDCs can obtain borrowing lines from banks secured by investor commitments, rather than individual assets.
  - Private BDC sponsors benefit from not having to expend the time and effort to register and qualify shares in individual states, unlike non-traded BDCs.
  - Similar to non-traded BDCs, but unlike listed BDCs, private BDCs can raise money incrementally and not have the associated "cash drag".

Private BDCs – Advantages

- Other potential advantages over alternative structures:
  - No SEC, FINRA or state registration fees. To put this into context, a $1 billion public offering would result in approximately $425,000 in SEC, FINRA and state registration fees.
  - Timing of effectiveness is more certain. Form 10s go effective by lapse of time 60 days after filing with the SEC. If comments are not resolved within that 60-day timeframe, the SEC will ask the registrant to withdraw and re-file with responses to comments.
  - Limited liability. Since private BDCs conduct private offerings, the offering memorandum is not subject to the liability provisions of the Securities Act of 1933, and the offering is not subject to FINRA Rule 2310.
  - Regulated entity. Private BDCs are subject to regulation under the 1940 Act, must have a chief compliance officer and must be advised by a federally-registered adviser. This may be an attractive feature for potential investors.

Private BDCs – Disadvantages

- Potential disadvantages to this structure include:
  - Cannot sell to the retail public. All purchasers must be accredited investors.
  - Restrictions on general solicitation. General solicitation not permitted unless relying on Rule 506(c), which requires that all purchasers be verified as accredited investors.
  - Compliance costs. Private BDCs are still subject to the provisions of the 1940 Act, which require a chief compliance officer, robust compliance policies and procedures, subject to the BDC to periodic inspections and examinations from the SEC and generally require that the BDC be advised by a federally-registered adviser. BDC is also subject to limitations on affiliated transactions and must have a majority-independent board of directors.
  - Reporting costs. BDCs, including private BDCs, also must comply with Exchange Act reporting requirements, which are more costly than for other private vehicles (including private funds.) Reports include annual reports, quarterly reports and current reports (i.e., 10-Ks, 10-Qs, etc.)

Private BDCs – Examples*

Name	Filing Date of N-54A	Commitment/ Draw-down?	Total Assets as of 12/31	Anticipated Term or Exit Strategy
TCG BDC, Inc. (fka Carlyle GMS Finance)	5/2/2013	Yes	$2.1 billion	IPO completed in June 2017
Golub Capital Investment Corp.	12/31/2014	Yes	$1.96 billion	Pending merger with Golub Capital BDC
TCW Direct Lending	12/30/2014	Yes	$1.38 billion	Share exchange
Audax Credit BDC	6/18/2015	Yes	$283 million	Tender offers
Crescent Capital BDC	6/5/2015	Yes	$505 million	IPO (IPO date recently extended)
Venture Lending & Leasing VIII	8/4/2015	Yes	$424 million	Liquidation
Parkview Capital Credit	2/12/2016	No	$67 million	Not noted
Owl Rock Capital Corp.	3/3/2016	Yes	$6.0 billion	Listing
Goldman Sachs Private Middle Market Credit	7/13/2016	Yes	$1.4 billion	7-year term
Hancock Park Corporate Income	7/15/2016	No	$30 million	Listing
AB Private Credit Investors Corp.	10/6/2016	Yes	$154 million	IPO

Private BDCs – Examples*

Name	Filing Date of N-54A	Commitment/ Draw-down?	Total Assets as of 12/31	Anticipated Term or Exit Strategy
Bain Capital Specialty Finance	10/6/2016	Yes	$1.8 billion	IPO completed in November 2018
Flat Rock Capital Corp.	6/21/2017	No	$78 million	Liquidity event 5-7 years after end of offering
Goldman Sachs Middle Market Lending Corp.	1/27/2017	Yes	$1.1 billion	Liquidity event within 6 years of final closing
GSV Growth Credit Fund	12/15/2016	Yes	$308 million	Exchange options
Golub Capital BDC 3	9/29/2017	Yes	$245 million	Liquidity event
TCG BDC II	10/2/2017	Yes	$520 million	Liquidity event following 7-year term
Venture Lending & Leasing IX	12/26/2017	Yes	$82 million	Liquidation
TCW Direct Lending VII	12/29/2017	Yes	$707 million	Liquidity event following 2nd anniversary of initial closing
BC Partners Lending Corp.	4/23/2018	Yes	$100,000	Liquidity event
Owl Rock Technology Finance Corp.	8/10/2018	Yes	$588 million	Listing 5 years from final closing
Oaktree Strategic Income II	8/3/2018	Yes	$85 million	Liquidity event

Private BDCs – Examples*

Name	Filing Date of N-54A	Commitment/ Draw-down?	Total Assets as of 12/31	Anticipated Term or Exit Strategy
SCP Private Credit Income BDC	10/4/2018	Yes	$1,000	Liquidity event with 6-year term
Blackstone/GSO Secured Lending Fund	10/26/2018	Yes	$574 million	Listing following 4-year term
Monroe Capital Income Plus Corp.	1/14/2019	No	$1,000	Liquidity event or exchange option following 3-year term
TCW Middle Market Lending Opportunities BDC	Not yet filed	**	**	**
Pharos Capital BDC	Not yet filed	Yes	$1,000	Liquidity event following 6-year term
Goldman Sachs Private Middle Market Credit II	5/2/2019	Yes	N/A	Liquidation following 5-year term

* *List current as of May 15, 2019.*

** *No Form 10 on file.*

Need more information?
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