

## SMALL BUSINESS CREDIT AVAILABILITY ACT

APRIL 24, 2018.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. HENSARLING, from the Committee on Financial Services,  
submitted the following

### R E P O R T

[To accompany H.R. 4267]

[Including cost estimate of the Congressional Budget Office]

The Committee on Financial Services, to whom was referred the bill (H.R. 4267) to amend the Investment Company Act of 1940 to change certain requirements relating to the capital structure of business development companies, to direct the Securities and Exchange Commission to revise certain rules relating to business development companies, and for other purposes, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

#### PURPOSE AND SUMMARY

On November 7, 2017, Representative Steve Stivers introduced H.R. 4267, to amend the Investment Company Act of 1940 to modernize the regulatory regime for Business Development Companies (“BDCs”). BDCs are investment vehicles designed to facilitate capital formation for small and middle-market companies. The legislation requires the SEC to streamline the offering, filing, and registration processes for BDCs to eliminate significant regulatory burdens. This legislation also increases a BDC’s ability to deploy capital to businesses by reducing the BDC’s asset coverage ratio—or required ratio of assets to debt—from 200% to 150% if certain requirements are met.

#### BACKGROUND AND NEED FOR LEGISLATION

The goal of H.R. 4267 is to help fuel capital formation for small- and middle-market businesses that have difficulty obtaining bank and other traditional financing by providing BDCs some relief from

a static regulatory regime that has not been significantly updated in more than 30 years since BDCs were created. In turn, these small- and middle-market businesses will have greater opportunity to grow and create jobs.

By 1980, many banks had pulled back from lending to small businesses after the banks suffered significant losses related to oil and real estate in the 1970s. Private equity and venture capital firms offered an alternative source of credit to small businesses, but they could not provide this credit to small, growing businesses because the Investment Company Act prohibited their securities from being owned by more than 100 persons. Thus, in 1980, Congress amended the Investment Company Act of 1940 to authorize the creation of BDCs to facilitate private finance investment in small- and middle-market businesses.

BDCs are closed-end funds that make investments in small and developing businesses and financially troubled firms. BDCs were created as a means of making capital more readily available to small, developing, and financially troubled companies that are not able to access public markets or other forms of conventional financing. By law, BDCs must invest at least 70% of their assets in so-called "eligible assets." The most common eligible assets are private and small public companies in the U.S. with \$5-to-\$150 million in annual revenues. This so-called middle market sector of the economy is responsible for one-third of the private sector GDP, and these businesses produce \$10 billion in revenues annually. Investments in such businesses must be privately negotiated, and the BDC is required to offer managerial assistance to these companies to meet specific business challenges.

While BDCs are a type of closed-end fund, they have greater flexibility than other investment companies in dealing with businesses in which they have invested and in issuing securities and compensating their managers. Further, BDCs do not need to register as investment companies under the Investment Company Act. Nonetheless, BDCs still must register their securities under the Securities Exchange Act of 1934 (Exchange Act) and are subject to the full reporting requirements under the Exchange Act, including the requirements to file Forms 10-K, 10-Q, and 8-K.

Recently, BDCs have invested in small- and medium-sized companies that provide vital services to the American public, including companies involved in disease treatment and prevention, education, information technology security, agriculture, and construction. Many BDCs specialize in financing acquisitions made by private equity firms. While wide variation exists among BDCs in the size of their investments, the companies they invest in and the industries in which they concentrate all share a common investment objective of making it easier for small- and medium-sized companies to obtain access to capital.

Today, funding from BDCs has become more important for small- and medium-sized businesses, as the stifling regulatory environment resulting from the regulatory overreaction to the financial crisis has restricted bank and other traditional financing options for these companies. Specifically, lending to small and medium-sized companies from commercial banks has fallen off due to the regulatory constraints and compliance burdens imposed by the Dodd-Frank Act, and BDCs now find themselves in a position similar to

the one at their creation over 30 years ago—i.e., addressing the unmet capital needs of small businesses. BDCs also are addressing important capital needs for middle-market businesses, as 79 BDCs exist in the U.S. with over \$80 billion in outstanding loans to middle-market businesses. Of these, 53 are publicly traded BDCs, allowing retail investors a chance to purchase shares in the growth of middle-market America.

Despite the important role that BDCs play in helping to fund small- and medium-sized businesses, the static BDC regulatory regime has prevented BDCs from playing as large a role as they might otherwise. The BDC regulatory regime has not been significantly updated in over 30 years since Congress authorized the creation of BDCs in 1980. Currently, BDCs are limited in the amount they can borrow, as their debt to equity ratio is capped at a 1:1. Modernizing the regulatory regime for BDCs will allow them to amplify financing for small- and medium-sized businesses at a time when these companies are struggling to access capital to support growth and job creation. Even a modest increase in the leverage ratio, though still below that of many other financial institutions, would enable BDCs to deploy significantly more capital to small- and mid-sized businesses, while still generating returns to their shareholders. To this end, H.R. 4267 allows BDCs—via board or shareholder vote to modestly increase their debt-to-equity ratio to 2:1.

Additionally, BDCs currently are unable to take advantage of streamlined offering rules that apply to traditional operating companies. In 2005, the SEC adopted rules that significantly modernized and streamlined the registration, communications, and offering processes for traditional offering companies. These reforms have been very successful, and many companies rely on them today. These reforms were primarily designed to: (1) streamline the securities registration process, especially for large reporting issuers referred to as WKSIs; (2) liberalize the flow of information from issuers to investors before and during offering periods; and (3) implement a new model for prospectuses based on electronic availability of the prospectuses, instead of physical delivery. The SEC excluded registered closed-end funds and BDCs from these reforms due to these funds being governed by a different, but parallel, regulatory framework. The SEC, to date, has not considered similar reforms to registered investment companies.

Like other companies that regularly raise capital through securities issuances, BDCs rely on pre-filed “shelf registration” statements, which are securities filings that allow companies to position themselves to issue additional securities. Because shelf registrations contain financial information that becomes outdated as companies publicly report more recent financial information, most companies incorporate subsequent financial reports in their shelf registrations by reference. BDCs, however, are prohibited from incorporating subsequent financial information by reference and instead must manually update their shelf registration statements each time they report new quarterly information (which slows a BDC’s ability to issue additional securities and makes it more expensive by requiring a BDC to hire lawyers, accountants, and printing firms to continually update its shelf-registration statements). To date, BDCs also have been barred from the benefits associated with

being a WKSI, which includes taking advantage of more flexible rules relating to communications with investors and the registration process.

To address these problems, H.R. 4267 provides parity on securities offering and related rules between BDCs and other operating companies, thereby streamlining disclosure requirements and reducing burdensome, duplicative regulatory paperwork for BDCs—while still ensuring that investors receive relevant and necessary disclosures. Specifically, this bill directs the SEC to revise its rules to allow BDCs to incorporate by reference and to permit BDCs to qualify as WKSI. These reforms would allow BDCs to raise capital in the same efficient manner as traditional operating companies, which would thus permit them to invest more of their dollars in small- and mid-sized businesses, as opposed to excessive compliance costs on outdated securities offering rules.

Finally, consistent with this legislation, in its October 2017 report on Capital Markets, issued pursuant to President Trump's February 3, 2017 Executive Order 13772, the Department of the Treasury included a recommendation that the SEC revise its securities offering reform rules to permit BDCs to utilize the same provisions available to other issuers who file Forms 10-K, 10-Q, and 8-K.

#### HEARINGS

The Committee on Financial Services held a hearing examining matters relating to H.R. 4267 on April 26, 2017, April 28, 2017 and November 3, 2017.

#### COMMITTEE CONSIDERATION

The Committee on Financial Services met in open session on November 14, 2017, and November 15, 2017, and ordered H.R. 4267 to be reported favorably to the House without amendment by a recorded vote of 58 yeas to 2 nays (Record vote no. FC-112), a quorum being present.

#### COMMITTEE VOTES

Clause 3(b) of rule XIII of the Rules of the House of Representatives requires the Committee to list the record votes on the motion to report legislation and amendments thereto. The sole recorded vote was on a motion by Chairman Hensarling to report the bill favorably to the House without amendment. The motion was agreed to by a recorded vote of 58 yeas to 2 nays (Record vote no. FC-112), a quorum being present.

## Record vote no. FC-112

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Hensarling .....	X			Ms. Maxine Waters (CA) .....	X		
Mr. McHenry .....	X			Mrs. Carolyn B. Maloney (NY) ..	X		
Mr. King .....	X			Ms. Velázquez .....	X		
Mr. Royce (CA) .....	X			Mr. Sherman .....	X		
Mr. Lucas .....	X			Mr. Meeks .....	X		
Mr. Pearce .....	X			Mr. Capuano .....		X	
Mr. Posey .....	X			Mr. Clay .....	X		
Mr. Luetkemeyer .....	X			Mr. Lynch .....		X	
Mr. Huizenga .....	X			Mr. David Scott (GA) .....	X		
Mr. Duffy .....	X			Mr. Al Green (TX) .....	X		
Mr. Stivers .....	X			Mr. Cleaver .....	X		
Mr. Hultgren .....	X			Ms. Moore .....	X		
Mr. Ross .....	X			Mr. Ellison .....	X		
Mr. Pittenger .....	X			Mr. Perlmutter .....	X		
Mrs. Wagner .....	X			Mr. Himes .....	X		
Mr. Barr .....	X			Mr. Foster .....	X		
Mr. Rothfus .....	X			Mr. Kildee .....	X		
Mr. Messer .....	X			Mr. Delaney .....	X		
Mr. Tipton .....	X			Ms. Sinema .....	X		
Mr. Williams .....	X			Mrs. Beatty .....	X		
Mr. Poliquin .....	X			Mr. Heck .....	X		
Mrs. Love .....	X			Mr. Vargas .....	X		
Mr. Hill .....	X			Mr. Gottheimer .....	X		
Mr. Emmer .....	X			Mr. Gonzalez (TX) .....	X		
Mr. Zeldin .....	X			Mr. Crist .....	X		
Mr. Trott .....	X			Mr. Kihuen .....	X		
Mr. Loudermilk .....	X						
Mr. Mooney (WV) .....	X						
Mr. MacArthur .....	X						
Mr. Davidson .....	X						
Mr. Budd .....	X						
Mr. Kustoff (TN) .....	X						
Ms. Tenney .....	X						
Mr. Hollingsworth .....	X						

## COMMITTEE OVERSIGHT FINDINGS

Pursuant to clause 3(c)(1) of rule XIII of the Rules of the House of Representatives, the findings and recommendations of the Committee based on oversight activities under clause 2(b)(1) of rule X of the Rules of the House of Representatives, are incorporated in the descriptive portions of this report.

## PERFORMANCE GOALS AND OBJECTIVES

Pursuant to clause 3(c)(4) of rule XIII of the Rules of the House of Representatives, the Committee states that H.R. 4267 will increase access to capital for small and middle-market businesses and facilitate job creation by modernizing the regulatory regime for BDCs.

## NEW BUDGET AUTHORITY, ENTITLEMENT AUTHORITY, AND TAX EXPENDITURES

In compliance with clause 3(c)(2) of rule XIII of the Rules of the House of Representatives, the Committee adopts as its own the estimate of new budget authority, entitlement authority, or tax expenditures or revenues contained in the cost estimate prepared by the Director of the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974.

## CONGRESSIONAL BUDGET OFFICE ESTIMATES

Pursuant to clause 3(c)(3) of rule XIII of the Rules of the House of Representatives, the following is the cost estimate provided by the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974:

U.S. CONGRESS,  
CONGRESSIONAL BUDGET OFFICE,  
*Washington, DC, March 16, 2018.*

Hon. JEB HENSARLING,  
*Chairman, Committee on Financial Services,  
House of Representatives, Washington, DC.*

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 4267, the Small Business Credit Availability Act.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Stephen Rabent.

Sincerely,

KEITH HALL,  
*Director.*

Enclosure.

*H.R. 4267—Small Business Credit Availability*

Summary: H.R. 4267 would direct the Securities and Exchange Commission (SEC) to amend certain regulations that affect business development companies (BDCs)—companies that operate like mutual funds to invest in the stocks of small private companies and that offer significant managerial assistance to issuers. H.R. 4267 would raise the limits on the amount of leverage allowed to a BDC if it met certain requirements. The bill also would eliminate

the exclusion of a BDC from qualifying as a well-known seasoned issuer (WKSI).<sup>1</sup>

The staff of the Joint Committee on Taxation (JCT) estimates that enacting H.R. 4267 would reduce federal revenues by \$33 million over the 2018–2028 period; therefore, pay-as-you-go procedures apply. Enacting the bill would not affect direct spending.

Using information from the SEC, CBO estimates that implementing H.R. 4267 would cost less than \$500,000 to amend certain regulations affecting BDCs and WKSIs. However, the SEC is authorized to collect fees sufficient to offset its annual appropriation; therefore, CBO estimates that the net effect on discretionary spending would be negligible.

CBO estimates that enacting H.R. 4267 would not affect direct spending and would not increase on-budget deficits by more than \$5 billion in any of the four consecutive 10-year periods beginning in 2028.

H.R. 4267 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act (UMRA).

Estimated cost to the Federal Government: The estimated budgetary effect of H.R. 4267 is shown in the following table. The costs of this legislation fall within budget function 370 (commerce).

	By fiscal year, in millions of dollars—												
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018– 2022	2018– 2027	
DECREASES IN REVENUES													
Estimated Revenues .....	*	*	-1	-3	-5	-6	-6	-6	-4	*	-15	-33	

Components may not sum to totals because of rounding; \* = between -\$500,000 and zero.

Basis of estimate: For this estimate, CBO assumes that H.R. 4267 will be enacted near the end of fiscal year 2018, that the necessary amounts will be appropriated near the start of each year, and that spending will follow historical patterns for the SEC.

### Revenues

JCT estimates that revenue losses under H.R. 4267 would result from a shift in business lending and taxable income from C corporations to BDCs, which are pass-through entities for tax purposes. Specifically, H.R. 4267 would allow BDCs to take on additional debt, increasing the amount they can borrow to a maximum of \$4 for every \$6 in assets. Under current law, a BDC can borrow up to \$3 for every \$6 it holds in assets.

Generally, the income of interests in pass-through entities (such as BDCs) that are owned by individual taxpayers is treated as personal income. That income is subject only to the individual income tax, and it is taxed at the personal income tax rate of the businesses' owners. In contrast, taxable income from C corporations is subject to the corporate income tax, and it can be taxed again at the individual level after distribution to shareholders or investors. JCT estimates that, by effectively shifting income from C corporations to BDCs, the bill would reduce tax revenues by \$33 million over the 2018–2027 period.

<sup>1</sup> Under current law, the SEC allows certain public companies, called WKSIs, to use streamlined registration and reporting procedures when issuing securities.

*Spending subject to appropriation*

Using information from the SEC, CBO estimates that implementing H.R. 4267 would cost less than \$500,000 each year to amend certain regulations affecting BDCs and WKSIs. However, the SEC is authorized to collect fees sufficient to offset its annual appropriation; therefore, CBO estimates that any net effect on discretionary spending from implementing the bill would be negligible, assuming appropriation actions consistent with that authority.

Pay-As-You-Go considerations: The Statutory Pay-As-You-Go Act of 2010 establishes budget-reporting and enforcement procedures for legislation affecting direct spending or revenues. The net changes in revenues that are subject to those pay-as-you-go procedures are shown in the following table.

CBO ESTIMATE OF PAY-AS-YOU-GO EFFECTS FOR H.R. 4267, THE SMALL BUSINESS CREDIT AVAILABILITY ACT, AS ORDERED REPORTED BY THE HOUSE COMMITTEE ON FINANCIAL SERVICES ON NOVEMBER 15, 2017

	By fiscal year, in millions of dollars—												
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018– 2022	2018– 2027	
NET INCREASE IN THE DEFICIT													
Statutory Pay-As-You-Go Impact .....	0	0	1	3	5	6	6	6	4	0	15	33	

Increase in long-term direct spending and deficits: CBO and JCT estimate that enacting H.R. 4267 would not affect direct spending and would not increase on-budget deficits by more than \$5 billion in any of the four consecutive 10-year periods beginning in 2028.

Mandates: H.R. 4267 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act.

Estimate prepared by: Federal Costs: Stephen Rabent; Federal Revenues: Staff of the Joint Committee on Taxation; Mandates: Jon Sperl.

Estimate approved by: H. Samuel Papenfuss, Deputy Assistant Director for Budget Analysis.

## FEDERAL MANDATES STATEMENT

This information is provided in accordance with section 423 of the Unfunded Mandates Reform Act of 1995.

The Committee has determined that the bill does not contain Federal mandates on the private sector. The Committee has determined that the bill does not impose a Federal intergovernmental mandate on State, local, or tribal governments.

## ADVISORY COMMITTEE STATEMENT

No advisory committees within the meaning of section 5(b) of the Federal Advisory Committee Act were created by this legislation.

## APPLICABILITY TO LEGISLATIVE BRANCH

The Committee finds that the legislation does not relate to the terms and conditions of employment or access to public services or accommodations within the meaning of the section 102(b)(3) of the Congressional Accountability Act.

#### EARMARK IDENTIFICATION

With respect to clause 9 of rule XXI of the Rules of the House of Representatives, the Committee has carefully reviewed the provisions of the bill and states that the provisions of the bill do not contain any congressional earmarks, limited tax benefits, or limited tariff benefits within the meaning of the rule.

#### DUPLICATION OF FEDERAL PROGRAMS

In compliance with clause 3(c)(5) of rule XIII of the Rules of the House of Representatives, the Committee states that no provision of the bill establishes or reauthorizes: (1) a program of the Federal Government known to be duplicative of another Federal program; (2) a program included in any report from the Government Accountability Office to Congress pursuant to section 21 of Public Law 111-139; or (3) a program related to a program identified in the most recent Catalog of Federal Domestic Assistance, published pursuant to the Federal Program Information Act (Pub. L. No. 95-220, as amended by Pub. L. No. 98-169).

#### DISCLOSURE OF DIRECTED RULEMAKING

Pursuant to section 3(i) of H. Res. 5, (115th Congress), the following statement is made concerning directed rulemakings: The Committee estimates that the bill requires one directed rulemaking.

H.R. 4267 requires the SEC to revise its rules to allow a BDC that has filed an election pursuant to section 54 of the Investment Company Act of 1940 to use the securities offering and proxy rules that are available to other issuers that are required to file reports under section 13(a) or section 15(d) of the Exchange Act.

#### SECTION-BY-SECTION ANALYSIS OF THE LEGISLATION

##### *Section 1. Short title*

This section cites H.R. 4267 as the “Small Business Credit Availability Act.”

##### *Section 2. Expanding access to capital for Business Development Companies*

This section provides for an increase in BDCs’ ability to deploy capital to businesses by reducing their asset coverage ratio, or required ration of assets to debt, from 200% to 150% if certain requirements are met. Further, after a board or general partner vote to take advantage of the new asset coverage ratio, the non-traded BDC must provide its shareholders with the ability to redeem 100% of their shares over the course of the year (25% per quarter). Alternatively, both traded and non-traded BDCs can immediately reduce their asset coverage ratio after a majority shareholder vote.

##### *Section 3. Parity for Business Development Companies regarding offering and proxy rules*

This section requires the SEC to revise its rules to allow BDCs to use the streamlined securities offering provisions available to other registrants under the Exchange Act, such as the ability to be a WKSI, use shelf offerings, and communicate directly with share-

holders. If the SEC does not act within one year to codify its order or update its rules, the provisions shall take effect and shall remain effective until the SEC acts.

CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3(e) of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, and existing law in which no change is proposed is shown in roman):

CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3(e) of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, and existing law in which no change is proposed is shown in roman):

**INVESTMENT COMPANY ACT OF 1940**

**TITLE I—INVESTMENT COMPANIES**

\* \* \* \* \*

**TRANSACTIONS WITH CERTAIN AFFILIATES**

SEC. 57. (a) It shall be unlawful for any person who is related to a business development company in a manner described in subsection (b) of this section, acting as principal—

(1) knowingly to sell any security or other property to such business development company or to any company controlled by such business development company, unless such sale involves solely (A) securities of which the buyer is the issuer, or (B) securities of which the seller is the issuer and which are part of a general offering to the holders of a class of its securities;

(2) knowingly to purchase from such business development company or from any company controlled by such business development company, any security or other property (except securities of which the seller is the issuer);

(3) knowingly to borrow money or other property from such business development company or from any company controlled by such business development company (unless the borrower is controlled by the lender), except as permitted in section 21(b) or section 62; or

(4) knowingly to effect any transaction in which such business development company or a company controlled by such business development company is a joint or a joint and several participant with such person in contravention of such rules and regulations as the Commission may prescribe for the purpose of limiting or preventing participation by such business development company or controlled company on a basis less advantageous than that of such person, except that nothing contained in this paragraph shall be deemed to preclude any

person from acting as manager of any underwriting syndicate or other group in which such business development company or controlled company is a participant and receiving compensation therefor.

(b) The provisions of subsection (a) of this section shall apply to the following persons:

(1) Any director, officer, employee, or member of an advisory board of a business development company or any person (other than the business development company itself) who is, within the meaning of section 2(a)(3)(C) of this title, an affiliated person of any such person specified in this paragraph.

(2) Any investment adviser or promoter of, general partner in, principal underwriter for, or person directly or indirectly either controlling, controlled by, or under common control with, a business development company (except the business development company itself and any person who, if it were not directly or indirectly controlled by the business development company, would not be directly or indirectly under the control of a person who controls the business development company), or any person who is, within the meaning of section 2(a)(3) (C) or (D), an affiliated person of any such person specified in this paragraph.

(c) Notwithstanding paragraphs (1), (2), and (3) of subsection (a), any person may file with the Commission an application for an order exempting a proposed transaction of the applicant from one or more provisions of such paragraphs. The Commission shall grant such application and issue such order of exemption if evidence establishes that—

(1) the terms of the proposed transaction, including the consideration to be paid or received, are reasonable and fair and do not involve overreaching of the business development company or its shareholders or partners on the part of any person concerned;

(2) the proposed transaction is consistent with the policy of the business development company as recited in the filings made by such company with the Commission under the Securities Act of 1933, its registration statement and reports filed under the Securities Exchange Act of 1934, and its reports to shareholders or partners; and

(3) the proposed transaction is consistent with the general purposes of this title.

(d) It shall be unlawful for any person who is related to a business development company in the manner described in subsection (e) of this section and who is not subject to the prohibitions of subsection (a) of this section, acting as principal—

(1) knowingly to sell any security or other property to such business development company or to any company controlled by such business development company, unless such sale involves solely (A) securities of which the buyer is the issuer, or (B) securities of which the seller is the issuer and which are part of a general offering to the holders of a class of its securities;

(2) knowingly to purchase from such business development company or from any company controlled by such business de-

velopment company, any security or other property (except securities of which the seller is the issuer);

(3) knowingly to borrow money or other property from such business development company or from any company controlled by such business development company (unless the borrower is controlled by the lender), except as permitted in section 21(b); or

(4) knowingly to effect any transaction in which such business development company or a company controlled by such business development company is a joint or a joint and several participant with such affiliated person in contravention of such rules and regulations as the Commission may prescribe for the purpose of limiting or preventing participation by such business development company or controlled company on a basis less advantageous than that of such affiliated person, except that nothing contained in this paragraph shall be deemed to preclude any person from acting as manager of any underwriting syndicate or other group in which such business development company or controlled company is a participant and receiving compensation therefor.

(e) The provisions of subsection (d) of this section shall apply to the following persons:

(1) Any person (A) who is, within the meaning of section 2(a)(3)(A), an affiliated person of a business development company, (B) who is an executive officer or a director of, or general partner in, any such affiliated person, or (C) who directly or indirectly either controls, is controlled by, or is under common control with, such affiliated person.

(2) Any person who is an affiliated person of a director, officer, employee, investment adviser, member of an advisory board or promoter of, principal underwriter for, general partner in, or an affiliated person of any person directly or indirectly either controlling or under common control with a business development company (except the business development company itself and any person who, if it were not directly or indirectly controlled by the business development company, would not be directly or indirectly under the control of a person who controls the business development company).

For purposes of this subsection, the term "executive officer" means the president, secretary, treasurer, any vice president in charge of a principal business function, and any other person who performs similar policymaking functions.

(f) Notwithstanding subsection (d) of this section, a person described in subsection (e) may engage in a proposed transaction described in subsection (d) if such proposed transaction is approved by the required majority (as defined in subsection (o)) of the directors of or general partners in the business development company on the basis that—

(1) the terms thereof, including the consideration to be paid or received, are reasonable and fair to the shareholders or partners of the business development company and do not involve overreaching of such company or its shareholders or partners on the part of any person concerned;

(2) the proposed transaction is consistent with the interests of the shareholders or partners of the business development

company and is consistent with the policy of such company as recited in filings made by such company with the Commission under the Securities Act of 1933, its registration statement and reports filed under the Securities Exchange Act of 1934, and its reports to shareholders or partners; and

(3) the directors or general partners record in their minutes and preserve in their records, for such periods as if such records were required to be maintained pursuant to section 31(a), a description of such transaction, their findings, the information or materials upon which their findings were based, and the basis therefor.

(g) Notwithstanding subsection (a) or (d), a person may, in the ordinary course of business, sell to or purchase from any company merchandise or may enter into a lessor-lessee relationship with any person and furnish the services incident thereto.

(h) The directors of or general partners in any business development company shall adopt, and periodically review and update as appropriate, procedures reasonably designed to ensure that reasonable inquiry is made, prior to the consummation of any transaction in which such business development company or a company controlled by such business development company proposes to participate, with respect to the possible involvement in the transaction of persons described in subsections (b) and (e) of this section.

(i) Until the adoption by the Commission of rules or regulations under subsections (a) and (d) of this section, the rules and regulations of the Commission under subsections (a) and (d) of section 17 applicable to registered closed-end investment companies shall be deemed to apply to transactions subject to subsections (a) and (d) of this section. Any rules or regulations adopted by the Commission to implement this section shall be no more restrictive than the rules or regulations adopted by the Commission under subsections (a) and (d) of section 17 that are applicable to all registered closed-end investment companies.

(j) Notwithstanding subsections (a) and (d) of this section, any director, officer, or employee of, or general partner in, a business development company may—

(1) acquire warrants, options, and rights to purchase voting securities of such business development company, and securities issued upon the exercise or conversion thereof, pursuant to an executive compensation plan offered by such company which meets the requirements of **[section 61(a)(3)(B)]** *section 61(a)(4)(B)*; and

(2) borrow money from such business development company for the purpose of purchasing securities issued by such company pursuant to an executive compensation plan, if each such loan—

(A) has a term of not more than ten years;

(B) becomes due within a reasonable time, not to exceed sixty days, after the termination of such person's employment or service;

(C) bears interest at no less than the prevailing rate applicable to 90-day United States Treasury bills at the time the loan is made;

(D) at all times is fully collateralized (such collateral may include any securities issued by such business development company); and

(E)(i) in the case of a loan to any officer or employee of such business development company (including any officer or employee who is also a director of such company), is approved by the required majority (as defined in subsection (o)) of the directors of or general partners in such company on the basis that the loan is in the best interests of such company and its shareholders or partners; or

(ii) in the case of a loan to any director of such business development company who is not also an officer or employee of such company, or to any general partner in such company, is approved by order of the Commission, upon application, on the basis that the terms of the loan are fair and reasonable and do not involve overreaching of such company or its shareholders or partners.

(k) It shall be unlawful for any person described in subsection (l)—

(1) acting as agent, to accept from any source any compensation (other than a regular salary or wages from the business development company) for the purchase or sale of any property to or for such business development company or any controlled company thereof, except in the course of such person's business as an underwriter or broker; or

(2) acting as broker, in connection with the sale of securities to or by the business development company or any controlled company thereof, to receive from any source a commission, fee, or other remuneration for effecting such transaction which exceeds—

(A) the usual and customary broker's commission if the sale is effected on a securities exchange;

(B) 2 per centum of the sales price if the sale is effected in connection with a secondary distribution of such securities; or

(C) 1 per centum of the purchase or sale price of such securities if the sale is otherwise effected,

unless the Commission, by rules and regulations or order in the public interest and consistent with the protection of investors, permits a larger commission.

(l) The provisions of subsection (k) of this section shall apply to the following persons:

(1) Any affiliated person of a business development company.

(2)(A) Any person who is, within the meaning of section 2(a)(3) (B), (C), or (D), an affiliated person of any director, officer, employee, or member of an advisory board of the business development company.

(B) Any person who is, within the meaning of section 2(a)(3) (A), (B), (C), or (D), an affiliated person of any investment adviser of, general partner in, or person directly or indirectly either controlling, controlled by, or under common control with, the business development company.

(C) Any person who is, within the meaning of section 2(a)(3)(C), an affiliated person of any person who is an affli-

ated person of the business development company within the meaning of section 2(a)(3)(A).

(m) For purposes of subsections (a) and (d), a person who is a director, officer, or employee of a party to a transaction and who receives his usual and ordinary fee or salary for usual and customary services as a director, officer, or employee from such party shall not be deemed to have a financial interest or to participate in the transaction solely by reason of his receipt of such fee or salary.

(n)(1) Notwithstanding subsection (a)(4) of this section, a business development company may establish and maintain a profit-sharing plan for its directors, officers, employees, and general partners and such directors, officers, employees, and general partners may participate in such profit-sharing plan, if—

(A)(i) in the case of a profit-sharing plan for officers and employees of the business development company (including any officer or employee who is also a director of such company), such profit-sharing plan is approved by the required majority (as defined in subsection (o)) of the directors of or general partners in such company on the basis that such plan is reasonable and fair to the shareholders or partners of such company, does not involve overreaching of such company or its shareholders or partners on the part of any person concerned, and is consistent with the interests of the shareholders or partners of such company; or

(ii) in the case of a profit-sharing plan which includes one or more directors of the business development company who are not also officers or employees of such company, or one or more general partners in such company, such profit-sharing plan is approved by order of the Commission, upon application, on the basis that such plan is reasonable and fair to the shareholders or partners of such company, does not involve overreaching of such company or its shareholders or partners on the part of any person concerned, and is consistent with the interests of the shareholders or partners of such company; and

(B) the aggregate amount of benefits which would be paid or accrued under such plan shall not exceed 20 per centum of the business development company's net income after taxes in any fiscal year.

(2) This subsection may not be used where the business development company has outstanding any stock option, warrant, or right issued as part of an executive compensation plan, including a plan pursuant to **section 61(a)(3)(B)** *section 61(a)(4)(B)*, or has an investment adviser registered or required to be registered under title II of this Act.

(o) The term "required majority", when used with respect to the approval of a proposed transaction, plan, or arrangement, means both a majority of a business development company's directors or general partners who have no financial interest in such transaction, plan, or arrangement and a majority of such directors or general partners who are not interested persons of such company.

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## CAPITAL STRUCTURE

SEC. 61. (a) Notwithstanding the exemption set forth in section 6(f), section 18 shall apply to a business development company to the same extent as if it were a registered closed-end investment company, except as follows:

【(1) The asset coverage requirements of section 18(a)(1) (A) and (B) applicable to business development companies shall be 200 per centum.】

*(1) Except as provided in paragraph (2), the asset coverage requirements of subparagraphs (A) and (B) of section 18(a)(1) (and any related rule promulgated under this Act) applicable to business development companies shall be 200 percent.*

*(2) The asset coverage requirements of subparagraphs (A) and (B) of section 18(a)(1) and of subparagraphs (A) and (B) of section 18(a)(2) (and any related rule promulgated under this Act) applicable to a business development company shall be 150 percent if—*

*(A) within five business days of the approval of the adoption of the asset coverage requirements described in clause (ii), the business development company discloses such approval and the date of its effectiveness in a Form 8-K filed with the Commission and in a notice on its website and discloses in its periodic filings made under section 13(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(a))—*

*(i) the aggregate value of the senior securities issued by such company and the asset coverage percentage as of the date of such company's most recent financial statements; and*

*(ii) that such company has adopted the asset coverage requirements of this paragraph and the effective date of such requirements;*

*(B) with respect to a business development company that issues equity securities that are registered on a national securities exchange, the periodic filings of the company under section 13(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(a)) include disclosures reasonably designed to ensure that shareholders are informed of—*

*(i) the amount of indebtedness and asset coverage ratio of the company, determined as of the date of the financial statements of the company dated on or most recently before the date of such filing; and*

*(ii) the principal risk factors associated with such indebtedness, to the extent such risk is incurred by the company; and*

*(C)(i) the application of this paragraph to the company is approved by the required majority (as defined in section 57(o)) of the directors of or general partners of such company who are not interested persons of the business development company, which application shall become effective on the date that is 1 year after the date of the approval, and, with respect to a business development company that issues equity securities that are not registered on a national securities exchange, the company extends, to each person who is a shareholder as of the date of the approval, an offer*

*to repurchase the equity securities held by such person as of such approval date, with 25 percent of such securities to be repurchased in each of the four quarters following such approval date; or*

*(ii) the company obtains, at a special or annual meeting of shareholders or partners at which a quorum is present, the approval of more than 50 percent of the votes cast of the application of this paragraph to the company, which application shall become effective on the date immediately after the date of the approval.*

[(2)] (3) Notwithstanding section 18(c), a business development company may issue more than one class of senior security representing indebtedness.

[(3)] (4) Notwithstanding section 18(d)—

(A) a business development company may issue warrants, options, or rights to subscribe or convert to voting securities of such company, accompanied by securities, if—

(i) such warrants, options, or rights expire by their terms within ten years;

(ii) such warrants, options, or rights are not separately transferable unless no class of such warrants, options, or rights and the securities accompanying them has been publicly distributed;

(iii) the exercise or conversion price is not less than the current market value at the date of issuance, or if no such market value exists, the current net asset value of such voting securities; and

(iv) the proposal to issue such securities is authorized by the shareholders or partners of such business development company, and such issuance is approved by the required majority (as defined in section 57(o)) of the directors of or general partners in such company on the basis that such issuance is in the best interests of such company and its shareholders or partners;

(B) a business development company may issue, to its directors, officers, employees, and general partners, warrants, options, and rights to purchase voting securities of such company pursuant to an executive compensation plan, if—

(i)(I) in the case of warrants, options, or rights issued to any officer or employee of such business development company (including any officer or employee who is also a director of such company), such securities satisfy the conditions in clauses (i), (iii), and (iv) of subparagraph (A); or (II) in the case of warrants, options, or rights issued to any director of such business development company who is not also an officer or employee of such company, or to any general partner in such company, the proposal to issue such securities satisfies the conditions in clauses (i) and (iii) of subparagraph (A), is authorized by the shareholders or partners of such company, and is approved by order of the Commission, upon application, on the basis that the terms of the proposal are fair and reasonable and

do not involve overreaching of such company or its shareholders or partners;

(ii) such securities are not transferable except for disposition by gift, will, or intestacy;

(iii) no investment adviser of such business development company receives any compensation described in section 205(a)(1) of title II of this Act, except to the extent permitted by paragraph (1) or (2) of section 205(b); and

(iv) such business development company does not have a profit-sharing plan described in section 57(n); and

(C) a business development company may issue warrants, options, or rights to subscribe to, convert to, or purchase voting securities not accompanied by securities, if—

(i) such warrants, options, or rights satisfy the conditions in clauses (i) and (iii) of subparagraph (A); and

(ii) the proposal to issue such warrants, options, or rights is authorized by the shareholders or partners of such business development company, and such issuance is approved by the required majority (as defined in section 57(o)) of the directors of or general partners in such company on the basis that such issuance is in the best interests of the company and its shareholders or partners.

Notwithstanding this paragraph, the amount of voting securities that would result from the exercise of all outstanding warrants, options, and rights at the time of issuance shall not exceed 25 per centum of the outstanding voting securities of the business development company, except that if the amount of voting securities that would result from the exercise of all outstanding warrants, options, and rights issued to such company's directors, officers, employees, and general partners pursuant to any executive compensation plan meeting the requirements of subparagraph (B) of this paragraph would exceed 15 per centum of the outstanding voting securities of such company, then the total amount of voting securities that would result from the exercise of all outstanding warrants, options, and rights at the time of issuance shall not exceed 20 per centum of the outstanding voting securities of such company.

[(4)] (5) For purposes of measuring the asset coverage requirements of section 18(a), a senior security created by the guarantee by a business development company of indebtedness issued by another company shall be the amount of the maximum potential liability less the fair market value of the net unencumbered assets (plus the indebtedness which has been guaranteed) available in the borrowing company whose debts have been guaranteed, except that a guarantee issued by a business development company of indebtedness issued by a company which is a wholly-owned subsidiary of the business development company and is licensed as a small business investment company under the Small Business Investment Act of 1958 shall not be deemed to be a senior security of such business development company for purposes of section 18(a) if the amount of the indebtedness at the time of its issuance by

the borrowing company is itself taken fully into account as a liability by such business development company, as if it were issued by such business development company, in determining whether such business development company, at that time, satisfies the asset coverage requirements of section 18(a).

(b) A business development company shall comply with the provisions of this section at the time it becomes subject to sections 55 through 65, as if it were issuing a security of each class which it has outstanding at such time.

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#### DISTRIBUTION AND REPURCHASE OF SECURITIES

SEC. 63. Notwithstanding the exemption set forth in section 6(f), section 23 shall apply to a business development company to the same extent as if it were a registered closed-end investment company, except as follows:

(1) The prohibitions of section 23(a)(2) shall not apply to any company which (A) is a wholly-owned subsidiary of, or directly or indirectly controlled by, a business development company, and (B) immediately after the issuance of any of its securities for property other than cash or securities, will not be an investment company within the meaning of section 3(a).

(2) Notwithstanding the provisions of section 23(b), a business development company may sell any common stock of which it is the issuer at a price below the current net asset value of such stock, and may sell warrants, options, or rights to acquire any such common stock at a price below the current net asset value of such stock, if—

(A) the holders of a majority of such business development company's outstanding voting securities, and the holders of a majority of such company's outstanding voting securities that are not affiliated persons of such company, approved such company's policy and practice of making such sales of securities at the last annual meeting of shareholders or partners within one year immediately prior to any such sale, except that the shareholder approval requirements of this subparagraph shall not apply to the initial public offering by a business development company of its securities;

(B) a required majority (as defined in section 57(o)) of the directors of or general partners in such business development company have determined that any such sale would be in the best interests of such company and its shareholders or partners; and

(C) a required majority (as defined in section 57(o)) of the directors of or general partners in such business development company, in consultation with the underwriter or underwriters of the offering if it is to be underwritten, have determined in good faith, and as of a time immediately prior to the first solicitation by or on behalf of such company of firm commitments to purchase such securities or immediately prior to the issuance of such securities, that the price at which such securities are to be sold is not less than a price which closely approximates the market

value of those securities, less any distributing commission or discount.

(3) A business development company may sell any common stock of which it is the issuer at a price below the current net asset value of such stock upon the exercise of any warrant, option, or right issued in accordance with [section 61(a)(3)] *section 61(a)(4)*.

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**INVESTMENT ADVISERS ACT OF 1940**

**TITLE II—INVESTMENT ADVISERS**

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**INVESTMENT ADVISORY CONTRACTS**

SEC. 205. (a) No investment adviser registered or required to be registered with the Commission shall enter into, extend, or renew any investment advisory contract, or in any way perform any investment advisory contract entered into, extended, or renewed on or after the effective date of this title, if such contract—

(1) provides for compensation to the investment adviser on the basis of a share of capital gains upon or capital appreciation of the funds or any portion of the funds of the client;

(2) fails to provide, in substance, that no assignment of such contract shall be made by the investment adviser without the consent of the other party by the contract; or

(3) fails to provide, in substance, that the investment adviser, if a partnership, will notify the other party to the contract of any change in the membership of such partnership within a reasonable time after such change.

(b) Paragraph (1) of subsection (a) shall not—

(1) be construed to prohibit an investment advisory contract which provides for compensation based upon the total value of a fund averaged over a definite period, or as of definite dates, or taken as of a definite date;

(2) apply to an investment advisory contract with—

(A) an investment company registered under title I of this Act, or

(B) any other person (except a trust, governmental plan, collective trust fund, or separate account referred to in section 3(c)(11) of title I of this Act), provided that the contract relates to the investment of assets in excess of \$1 million,

if the contract provides for compensation based on the asset value of the company or fund under management averaged over a specified period and increasing and decreasing proportionately with the investment performance of the company or fund over a specified period in relation to the investment record of an appropriate index of securities prices or such other measure of investment performance as the Commission by rule, regulation, or order may specify;

(3) apply with respect to any investment advisory contract between an investment adviser and a business development

company, as defined in this title, if (A) the compensation provided for in such contract does not exceed 20 per centum of the realized capital gains upon the funds of the business development company over a specified period or as of definite dates, computed net of all realized capital losses and unrealized capital depreciation, and the condition of ~~section 61(a)(3)(B)(iii)~~ *section 61(a)(4)(B)(iii)* of title I of this Act is satisfied, and (B) the business development company does not have outstanding any option, warrant, or right issued pursuant to ~~section 61(a)(3)(B)~~ *section 61(a)(4)(B)* of title I of this Act and does not have a profit-sharing plan described in section 57(n) of title I of this Act;

(4) apply to an investment advisory contract with a company excepted from the definition of an investment company under section 3(c)(7) of title I of this Act; or

(5) apply to an investment advisory contract with a person who is not a resident of the United States.

(c) For purposes of paragraph (2) of subsection (b), the point from which increases and decreases in compensation are measured shall be the fee which is paid or earned when the investment performance of such company or fund is equivalent to that of the index or other measure of performance, and an index of securities prices shall be deemed appropriate unless the Commission by order shall determine otherwise.

(d) As used in paragraphs (2) and (3) of subsection (a), “investment advisory contract” means any contract or agreement whereby a person agrees to act as investment adviser to or to manage any investment or trading account of another person other than an investment company registered under title I of this Act.

(e) The Commission, by rule or regulation, upon its own motion, or by order upon application, may conditionally or unconditionally exempt any person or transaction, or any class or classes of persons or transactions, from subsection (a)(1), if and to the extent that the exemption relates to an investment advisory contract with any person that the Commission determines does not need the protections of subsection (a)(1), on the basis of such factors as financial sophistication, net worth, knowledge of and experience in financial matters, amount of assets under management, relationship with a registered investment adviser, and such other factors as the Commission determines are consistent with this section. With respect to any factor used in any rule or regulation by the Commission in making a determination under this subsection, if the Commission uses a dollar amount test in connection with such factor, such as a net asset threshold, the Commission shall, by order, not later than 1 year after the date of enactment of the Private Fund Investment Advisers Registration Act of 2010, and every 5 years thereafter, adjust for the effects of inflation on such test. Any such adjustment that is not a multiple of \$100,000 shall be rounded to the nearest multiple of \$100,000.

(f) **AUTHORITY TO RESTRICT MANDATORY PRE-DISPUTE ARBITRATION.**—The Commission, by rule, may prohibit, or impose conditions or limitations on the use of, agreements that require customers or clients of any investment adviser to arbitrate any future dispute between them arising under the Federal securities laws, the rules and regulations thereunder, or the rules of a self-regu-

latory organization if it finds that such prohibition, imposition of conditions, or limitations are in the public interest and for the protection of investors.

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