

SEC Permits BDCs to Analyze LPs as Stockholders for Certain Co-Investments

December 12, 2014

On December 5, 2014, the Securities and Exchange Commission, through the Chief Accountant's Office of its Investment Management Division, issued a Guidance Update in response to a public inquiry regarding co-investment transactions involving a business development company (BDC) and a limited partner of a private partnership that is under common control with a BDC.

Section 57(a) of the Investment Company Act of 1940 (1940 Act) restricts BDCs from engaging in transactions with certain affiliates identified in Section 57(b) of the 1940 Act (close affiliates). Section 57(b) provides that anyone identified in subsections (C) or (D) of the "affiliated person" definition found in Section 2(a)(3) of the 1940 Act of another close affiliate of a BDC will also be a close affiliate of the BDC. Because "partners" are identified in subsection (D) of the "affiliated person" definition without reference to the type or amount of partnership interest owned, a limited partner of a private partnership that is a close affiliate may be treated as a close affiliate of the BDC even if such limited partner holds 25% or less of the private partnership's voting securities. As a result, the analysis regarding a BDC's ability to complete a transaction where a particular entity or person is involved may be different depending on whether the person or entity being analyzed is a stockholder of an affiliated corporation or a partner of an affiliated private partnership.

The Guidance explains that a BDC may treat a limited partner of a private partnership that is an affiliated person of a BDC as if such limited partner was a stockholder of the private partnership where the limited partner would otherwise be a close affiliate of the BDC solely because the private partnership is organized as a limited partnership instead of a corporation. The result of this is that such limited partners that own less than 5% of the private partnership's voting securities would not be subject to Section 57 and such limited partners that own more than 5% but not more than 25% of the private partnership's voting securities would instead be treated as persons identified in Section 57(e) (remote affiliates) and may engage in certain transactions with the BDC if the BDC obtains the board approval of the transaction required by Section 57(f).

The complete Guidance Update can be viewed at

<http://www.sec.gov/investment/im-guidance-2014-12.pdf>