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SEC Set to Approve More Flexible Co-Investment Relief for BDCs and Closed-End Funds

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On April 3, 2025, the U.S. Securities and Exchange Commission ("*SEC*") issued a notice indicating its intent to grant Franklin Square's ("*FS*") exemptive relief application (the "*FS Application*")[1] permitting certain business development companies and closed-end investment companies (collectively, "*Regulated Funds*") to engage in co-investment transactions under a new, simplified and principles-based framework. This framework departs from the more prescriptive traditional precedents and establishes a streamlined model for co-investment relief that is expected to give managers of Regulated Funds greater flexibility to engage in co-investment opportunities and enhance retail investor access to private markets.

Streamlining of Pre-Boarding Investment and Disposition Procedures

The FS Application simplifies the board review process for follow-on investments and dispositions by eliminating the distinction between transactions involving investments previously made by an affiliated fund outside of the co-investment program ("*pre-boarding investments*") and those made under the program. Under the prior framework, pre-boarding investments triggered enhanced board review and allocation procedures. The FS Application replaces this dual-track approach with a simplified framework that is agnostic to pre-boarding status.

For acquisitions, a Regulated Fund may acquire a security of an issuer in which an affiliated entity already holds an interest without Required Majority[2] board approval if the Regulated Fund already holds the same security and all participating affiliates invest proportionally to their then-current holdings. In all other cases, such as when the Regulated Fund is initiating a new position or increasing its holdings disproportionately, the Required Majority must approve the transaction pursuant to Section 57(f) of the 1940 Act.

For dispositions, the sole consideration is who initiates the transaction. If an affiliated entity initiates the disposition, the adviser to the Regulated Fund must be notified and the Regulated Fund given the opportunity to participate on a pro rata basis. If a Regulated Fund initiates the disposition, the Required Majority must take the steps set forth in Section 57(f) of the 1940 Act, unless all affiliated entities dispose of their holdings proportionally or the asset is a tradable security.

Elimination of "Board-Established Criteria" and Reduced Board Approval Requirements

The FS Application also adopts a more principles-based oversight model replacing the more prescriptive, criteria-driven framework of the prior exemptive orders. It eliminates the concept of "Board-Established Criteria" and reduces the frequency with which Regulated Fund boards must approve individual co-investment transactions. Outside of the Required Majority approvals required for certain pre-boarding acquisitions and Regulated Fund-initiated dispositions, the board's role is now more focused on program-level oversight, including:

- **Initial Policy Approval:** Prior to a fund's participation in co-investment transactions, the board (including a Required Majority) must review and approve fund-level co-investment policies and procedures ensuring they are reasonably designed to prevent the fund from being disadvantaged and to ensure compliance with the terms of the exemptive order.
- **Reduced Transaction-Level Approvals:** The board will have broad discretion to oversee the co-investment program in the exercise of its reasonable business judgment, generally without being required to receive notice of or approve individual co-investment transactions.
- **Simplified Board Reporting:** Previously, advisers were required to provide detailed, transaction-specific quarterly reports identifying (i) all co-investment opportunities not offered to the Regulated Fund that fell within its objectives and Board-Established Criteria, (ii) all follow-on investments and dispositions by affiliated entities in issuers held by the Regulated Fund, and (iii) all declined or missed opportunities. Under the new framework, advisers and chief compliance officers can instead provide less granular quarterly and annual reports relating to the fund's participation in co-investment transactions, the implementation of relevant policies, material changes to affiliated entities' participation in the program and any other information the board may request.

- **Material Compliance Notifications:** Advisers and chief compliance officers must notify the board of any material compliance matters related to a Regulated Fund's participation in the co-investment program or applicable policies and procedures.

Expanded Flexibility for Joint Ventures, Sub-Advised Regulated Funds and 3(c) Funds

The FS Application broadens the scope of entities eligible to participate in co-investment transactions by expanding the definition of "Regulated Fund" to include:

- Joint venture subsidiaries of a Regulated Fund formed with an unaffiliated partner, provided that portfolio decisions are made by a committee that includes representatives of the Regulated Fund.
- Sub-advised Regulated Funds where the primary adviser and sub-adviser are unaffiliated. In such cases, if the sub-adviser qualifies as an affiliated "Adviser" but the primary adviser does not, the unaffiliated primary adviser will be treated as an Adviser solely for the purposes of allocating shared expenses pro rata (Condition 3) and limiting transaction-related compensation in co-investment transactions (Condition 4).

Although the original FS Application included open-end funds within the scope of the requested relief, the amended application that is the subject of the SEC's notice does not.

In addition, the relief extends to a broader range of affiliated private funds by permitting any entity that would be an investment company but for Section 3(c) of the 1940 Act or Rule 3a-7 thereunder to rely on the relief, provided it is advised by an Adviser. Prior exemptive orders generally applied only to entities relying specifically on Sections 3(c)(1), 3(c)(7) or 3(c)(5)(C).

Other notable aspects of the FS Application include:

- **Continuation of "Same Time, Same Price, Same Rights" Requirement:** As in prior precedents, the FS Application continues to condition all co-investment transactions on the requirement that such transactions occur "at the same time, for the same price and with the same conversion, financial reporting and registration rights, and with substantially the same other terms" as between each participating Regulated Fund and affiliated entity.
- **Reliance on Multiple Co-Investment Orders**: Prior exemptive relief often included a footnote prohibiting reliance on more than one co-investment order.

While this restriction was not grounded in a specific rule, the SEC staff in recent years has required applicants to include it as a condition for issuance of an order. The FS Application eliminates that restriction, instead explicitly allowing Regulated Funds to rely on multiple exemptive orders, provided that board materials and fund records clearly identify which order is being relied upon for any given transaction.

- **Conditions of Any Prior Co-Invest Relief Will Continue to Apply to Investments Acquired Under that Prior Relief:** Acknowledging that FS previously obtained exemptive orders under the more traditional co-investment relief framework, the FS Application provides that co-investments made in reliance on such prior orders will continue to comply with those prior orders with respect to any follow-on investments or dispositions relating to investments originally acquired under such relief.
- **Streamlined Treatment of Proprietary Accounts as "Affiliated Entities":** Rather than distinguishing affiliated funds from proprietary accounts through the use of separate, nested defined terms, as was common under prior precedents, the FS Application takes the more streamlined approach of directly incorporating adviser accounts that hold assets in a principal capacity into the definition of "Affiliated Entity" in the first instance.

Key Takeaways

- The SEC's pending approval of the FS Application marks a significant shift in the regulatory framework governing co-investment transactions involving Regulated Funds. The new exemptive relief adopts a principles-based framework that is expected to streamline the co-investment process by eliminating the need for board approval of individual transactions in many cases and easing restrictions on co-investments in portfolio companies where affiliates may already hold positions. This new approach is designed to offer sponsors greater flexibility in structuring co-investments, especially in private placements, and to allow for easier adaptation to evolving investment strategies and market conditions, while also expanding retail investor access to private markets.
- Going forward, the SEC is expected to place greater emphasis on the nature and adequacy of board oversight, including the frequency, scope and substance of information provided to boards on a quarterly and annual basis regarding a Regulated Fund's participation in co-investments. We expect at least initially the nature and level of information boards receive will remain in line with the form and nature of information presently required to be provided to boards under the SEC's existing co-investment exemptive orders.
- The updated framework is expected to make it easier for joint ventures between advisers and sub-advisers operating across different investment platforms to

participate in co-investment opportunities. This marks a shift from the prior approach, where participation was generally limited to affiliated advisers. Unaffiliated joint ventures previously had to seek custom relief naming both advisers as applicants, which could create complications, particularly where a sponsor sought to rely on pre-existing exemptive relief that included limitations on reliance on multiple co-invest orders. The practical implications of this new relief for unaffiliated joint ventures will become clearer over time.

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[1] *See* FS Credit Opportunities Corp., et al. (File No. 812-15706), application filed Feb. 21, 2025, available here.

[2] As defined in Section 57(o) of the Investment Company Act of 1940 (the "1940 Act").

Related Professionals

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