



December 4th, 2020

The Honorable Jay Clayton  
Chairman  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549

Dear Chairman Clayton:

The Small Business Investor Alliance (SBIA) appreciates the ongoing work of the Securities and Exchange Commission (SEC or Commission) to address issues facing our capital markets in the wake of the economic disruption caused by the COVID-19 pandemic.

Given the enormous challenges that small and middle market American businesses continue to experience and the importance of capital access for these businesses, the SBIA writes to request an extension of the April 8<sup>th</sup>, 2020 order granting exemptive relief for certain business development company (BDC) co-investment transactions.<sup>1</sup> (“Co-Investment Order” or “Order”) While an immediate extension into 2021 is necessary to allow BDCs to continue to engage in such transactions, we believe the Commission should ultimately establish a permanent regulatory framework that facilitates BDC co-investment transactions.

When the SEC issued the Co-Investment Order, it was widely believed that the extreme actions taken to deal with the pandemic would be followed by a swift economic recovery and a return to life as normal. Instead, the pandemic and economic disruptions have continued to linger, with many state and local governments imposing further restrictions on businesses in recent weeks. Countless Main Street and middle market businesses have had to fundamentally re-orient their operations to manage through this unprecedented crisis and are unable to fully prepare for the future given the uncertainties the pandemic has created. Continued access to capital for these businesses is critical for them to survive and retain their employees.

By statute, BDCs are required to invest at least 70% of their assets in certain “qualifying assets,” which generally consists of investments in U.S. businesses that are privately owned and have a market capitalization of less than \$250 million. BDCs have played an indispensable role over the last several months in helping provide capital to the middle market. Given that the economy is not likely to fully recover to its pre-COVID levels until well into next year, we believe the SEC should take further action to ensure BDCs can continue to be a reliable partner for Main Street businesses.

### **Co-Investment Transactions**

It has become increasingly common for a BDC and its affiliated funds to enter into a co-investment agreement when the BDC is externally managed on a platform with private funds that follow a similar strategy. Historically, co-investment transactions have been overseen by a patchwork of no-action letters issued under the Investment Company Act as well as over 50 exemptive orders that the SEC has granted to

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<sup>1</sup> Order under Sections 6(c), 17(d), 38(a) and 57(i) of the Investment Company Act of 1940 and Rule 17d-1 thereunder granting exemptions from specified provisions of the Investment Company Act and certain rules thereunder (April 8, 2020).

individual BDCs. This disparate approach to regulation has left BDCs and investors continually guessing as to when and under what circumstances certain co-investment transactions would be permitted.

The Co-Investment Order – which is set to expire on December 31<sup>st</sup> of this year – temporarily cleared up some of this confusion. The Order permits BDCs currently operating under an exemptive order to participate in a follow-on investment, provided that the follow-on investment adheres to the terms and conditions of the existing exemptive order.

The SBIA welcomed the issuance of the Co-Investment Order which has resulted in several positive developments in the market. For example, the SBIA has collected the following examples of BDCs using the Order to engage in co-investment transactions:

- **Case #1:** In 2018, an Advisor made an \$87 million 2<sup>nd</sup> lien term loan investment across its BDC and a number of private funds pursuant to its co-investment exemptive order. In the aggregate, the Advisor's funds held the entire 2<sup>nd</sup> lien term loan. In October 2020, the company was looking for an additional \$35 million to fund its M&A activities. The private funds that held the 2<sup>nd</sup> lien were either out of their investment period or had very limited liquidity. The BDC's investment in the 2<sup>nd</sup> lien was already \$21,250,000. The BDC participated in the follow-on with other new private funds but capped its aggregate position at \$27.5 million as its maximum desired position given that this was 2<sup>nd</sup> lien. Absent the temporary relief, the BDC and other private funds that held the 2<sup>nd</sup> lien would not have been able to provide the full \$35 million in incremental financing and the company might have refinanced them out altogether in order to raise the capital.
- **Case #2:** In 2017, 2019 and 2020, an Advisor had made aggregate investments of \$52.5 million across its BDC and one private fund pursuant to its co-investment exemptive order. In November 2020, the company was looking for \$7.5 million in incremental financing to support its M&A activities. The private fund that held the investment was out of its investment period. The BDC's investment in the issuer was already \$43 million and it did not wish to add to that position. The Advisor was able to bring in new private funds to provide the incremental financing. Absent the temporary relief, the BDC may have been forced to decide between upsizing beyond its comfort level or being refinanced out altogether.

Absent an extension of the Order, transactions similar to those described above would not occur, and capital flows would be restricted to the businesses in our economy that need it most.

*Importantly, in the period since the Order was issued, no investor protection or market risk issues have materialized because of the Order. We can think of no compelling investor protection or other concern that should preclude the SEC from extending the Order into 2021. Additionally, given the clear benefits to Main Street businesses and investors that have resulted from the Order being in effect, we believe the SEC should ultimately undertake a rulemaking process to codify the regulatory framework surrounding co-investment transactions and enhance the ability of BDCs to engage in such transactions.*

Chairman Jay Clayton  
U.S. Securities and Exchange Commission  
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The SBIA and its members welcome any opportunity to engage with the Commission or SEC staff to further discuss this issue in more detail.

Sincerely,

A handwritten signature in blue ink that reads "Brett Palmer".

Brett Palmer  
President

cc: The Honorable Caroline A. Crenshaw  
The Honorable Allison Herren Lee  
The Honorable Hester M. Peirce  
The Honorable Elad L. Roisman

Dalia O. Blass  
Director, Division of Investment Management