



Cynthia M. Krus  
John J. Mahon

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# BDC Disclosure Developments

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# Overview

- SEC review and comment process generally
- Disclosure regarding valuation process
- Increased focus on disclosure regarding derivatives
- Emphasis on more specific risk factor disclosure
- Greater focus on Securities Act issues
- Recent comments on “Fees and Expenses”
- Shelf offering disclosure issues
- Proxy disclosure issues
- Implementation of “proxy access”

# SEC Review and Comment Process

- SEC review process
  - Timing issues
  - Examiners
- Recent comments
  - Borrowings
  - Dilution issues
  - Valuation
  - Risks
- SEC rulemaking
  - Revisiting disclosure regime
  - Timing

# Valuation Disclosure

- Discussion of valuation policies
- Use of third-party valuation firms
- Description of methodologies
- Questions regarding application of valuation policies

# Increased Focus on Derivatives

- SEC staff has issued guidance on derivatives-related disclosure by investment companies
- Focus is principally on mutual funds, but SEC examiners have referenced the guidance in connection with reviews of BDC filings
- Disclosure regarding use of derivatives must be specific, rather than generic, in nature
  - Interest rate/currency hedging activities should be identified, if applicable
  - A BDC's actual exposure to derivatives should be clear to investors
  - Risk factor disclosure should highlight the risks associated with a BDC's current or intended use of derivatives
- BDCs are also subject to the disclosure requirements of Item 305 of Regulation S-K (i.e., market risk disclosure)
  - Exposure to interest rate or currency fluctuations, including through derivatives, may require detailed tabular disclosure

# Emphasis on More Specific Risks

- SEC staff has indicated its desire for less generic, repetitive risk factors, with a focus on detailing the specific risks faced by an issuer
- For example, generic risk factors regarding market or economic factors should be tailored to indicate how a downturn would specifically impact an issuer's operations, portfolio companies, etc.
- Risk factors should also be evaluated quarterly for necessary additions or revisions
- SEC staff has also indicated that it is exploring possible revisions to the current risk factor disclosure requirements, to make the disclosure shorter and more focused on the most significant and relevant risks an issuer faces

# Securities Act Issues

- The staff of Investment Management has historically been less focused on Securities Act issues, such as Regulation D compliance and integration issues involving private placements
- Recent SEC staff reviews, however, have included significant substantive comments focused on Securities Act issues, particularly in the IPO context
- Issuers have been required to provide detailed integration analyses to the SEC staff in connection with private placement activities
- The SEC staff has also increased its focus on selling stockholder transactions, as that practice has become more common in the BDC space

# Fees and Expenses Disclosure

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- Recent staff comments have focused on the accuracy of estimates and assumptions used in preparing the “Fees and Expenses” tabular disclosure
  - SEC staff has indicated that amounts should reflect actual expected expenses
  - Annualized amounts or amounts from prior years may be used, provided that an issuer confirms that those remain accurate indicators of expected future expenses
- The SEC staff has in one limited case issued a comment requiring the expense “example” included in the “Fees and Expenses” disclosure to assume that all earnings are in the form of capital gains
  - Typically, a BDC assumes no incentive fee in the “example,” as the required rate of return generally falls below a BDC’s hurdle rate
  - As capital gains incentive fees typically have no hurdle rate, the SEC staff was effectively requiring that incentive fees be assumed for purposes of preparing the “example”

# Shelf Offering Issues

- **Principal underwriter issue**
  - A lead or co-manager for an offering could be viewed as a “principal underwriter” for 1940 Act purposes
  - Ownership of shares of a lead or co-manager for an offering could cause an otherwise independent director to be “interested” for purposes of that offering
- **“At-the-market” or “ATM” offerings**
  - Investment bank is engaged to sell shares into the existing trading market on demand from the issuer
  - Share volumes are generally small
  - Base prospectus must contemplate at-the-market offerings
  - Each 10-Q, 10-K and material 8-K filing must also be filed as a prospectus supplement
  - Typically require quarterly bring-down comfort letters and legal opinions

# Proxy Disclosure Issues

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- **Enhanced Director and Nominee Disclosure**
  - Must describe the particular skills, experience or attributes that qualify such person to serve as a director
  - Diversity considerations in director nominations are required to be discussed
- **Disclosure of Board's Role in Risk Oversight**
  - Must discuss how the board oversees risks, including how it interacts with senior management in ensuring management of such risks
- **Board Leadership Disclosure**
  - Must describe the board's leadership structure
  - Purpose for non-independent chairman must be explained, if applicable

# Proxy Access Implications

- Issuers would be required to include disclosure regarding qualifying stockholder nominations in their own proxy materials
- Potentially allows contested elections at a significantly lower cost-point for insurgent candidates
  - Proxy contests have historically required significant time and expense to undertake
- Unclear whether restrictions on use of proxy access by potential acquirers will be sufficient deterrent to abuse
  - Restrictions are based on current intent of insurgent candidates

# Proxy Access – Action Items

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- Analyze existing shareholder base
  - Identify potential issues
  - Work with proxy solicitation firms
- Review corporate governance documents
  - Advance notice provisions
  - Confidentiality policy
  - Board qualifications
- Reach out to institutional investors