I. SEC Staff Update

Disclaimer

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1. The staff of the Division of Investment Management (SEC IM staff) stated that the Commission remains fully operational during the Coronavirus (COVID-19) pandemic and, beyond health and safety, is focused on maintaining continuity of Commission operations, monitoring market functions and system risks, providing prompt, targeted regulatory relief and guidance to stakeholders, and working with other financial regulators, as needed, to coordinate efforts. The SEC IM staff has received many questions from registrants and continues both financial statement reviews and rulemaking efforts, though the Commission has stated on the public webpage discussing the SEC’s COVID-19 Response under section titled “Effect on Comment Periods for Certain Pending Actions” that they understand challenges associated with COVID-19 may impair stakeholder’s ability to meet current comment periods and will not take final action on several proposals before May 1, 2020 including:

   a. Amendments to Rule 2-01, Qualifications of Accountants;
   b. Amending the “Accredited Investor” Definition;
   c. Use of Derivatives by Registered Investment Companies and Business Development Companies.

2. The SEC IM staff created an IM COVID-19 Response FAQ, where they have organized responses to questions about funds and advisers affected by COVID-19 for ease of reference. These responses represent the views of the staff of the Division, however they reference both staff actions and Commission actions, as well as contact information for both specific and general questions.

   a. Investment Adviser-related highlights:
      • New and updated Custody Rule FAQs regarding:
         1. inadvertent receipt of client securities when an adviser’s personnel may be unable to access mail or deliveries (new Question II.1);
         2. inability to complete surprise examination (new Question IV.7); and
         3. custody of certain privately issued securities that are evidenced by physical certificates (new Question VII.4).
Existing Custody Rule FAQs regarding:

1. inability of a pooled investment vehicle to distribute its audited financial statements within 120 days after its fiscal year – the IM staff referenced existing Question VI.9 from the Custody Rule FAQs (for more detail, refer to the SEC Staff Update from the March 2020 EP meeting highlights) on the COVID-19 landing page.

The EP inquired whether (i) Fund of Funds and (ii) Funds that invest in Fund of Funds would be afforded similar relief to that given in existing Question VI.9 with respect to meeting the 180 day and 260 deadline, respectively, given for stand-alone funds in FAQ VI.9, i.e. “The Division would not recommend enforcement action for a violation of rule 206(4)-2 against an adviser that is relying on rule 206(4)-2(b)(4) and that reasonably believed that the pool’s audited financial statements would be distributed within the 120-day deadline, but failed to have them distributed in time under certain unforeseeable circumstances.” Subsequent to the meeting, the SEC IM staff directed the EP to Custody Rule FAQ Question VI.9 which was modified on April 27, 2020 to address this question.

The SEC IM staff also noted that, as stated in March 20, 2020 OCIE Statement on Operations and Exams – Health, Safety, Investor Protection and Continued Operations are our Priorities, “reliance on regulatory relief will not be a risk factor utilized in determining whether OCIE commences an examination.”

b. Investment Company-related highlights:

- The IM staff noted there are several Commission and Staff action items listed on IM’s page related to investment companies that have been released over the past month, including actions related to in-person board meetings, inter-fund lending, affiliate transactions, and certain filing requirements.

- The IM staff highlighted an IM staff statement reminding investment company issuers of their obligations under section 10(a)(3) of the Securities Act of 1933 to update the information in their prospectuses, including the required underlying certified financial statements. The statement also reminds investment companies of their information delivery obligations for sales of fund shares to new investors and encourages investment companies to communicate with investors about their delivery preferences. The SEC IM staff highlighted certain specific delivery obligations for existing vs. new investors.

- The Commission announced temporary, conditional relief for BDCs that allows additional flexibility in certain requirements to make additional investments in small and mid-sized businesses, including those impacted by COVID-19, subject to certain protection conditions. The relief focuses on two areas:
  (1) issuance of senior securities and asset coverage, and
  (2) expanded relief for BDCs with existing co-investment orders.

- The relief in both areas is intended to allow for BDCs to continue to facilitate providing capital to small and mid-sized businesses in light of the current market environment. Absent these exemptions, they may be unable to do so, either because the BDC cannot satisfy their asset coverage requirements due to temporary mark-downs in the value of their investments or from the prohibition of certain affiliated funds from participating in additional follow-on investments.

  (1) The first area of relief for BDCs relates to the issuance of senior securities and calculation of an Adjusted Asset Coverage Ratio, as described in the Order. During the exemption period, a BDC may issue or sell a senior security that represents an indebtedness or that is a stock (together, the “covered senior securities”), if certain provisions are met.

- The EP and the SEC IM staff further discussed the adjusted asset coverage calculation included in the relief, noting it included an example where the BDC had a statutorily determined limitation of 150% and its asset coverage calculation did not fall below
that limitation, but still determined to utilize the relief. The EP and SEC IM staff discussed an additional scenario where a BDCs asset coverage calculation at the calculation date fell below the limitation:

Example *Adjusted Asset Coverage Ratio* Calculation:

For example, a BDC has a 190% asset coverage ratio on December 31, 2019. Its asset coverage ratio declines to 130% in April on the date of calculation due to a 25% decline in asset values, not using the Adjusted Portfolio Value, and 190% if it calculated the ratio using the Adjusted Portfolio Value (without the 25% decline in asset values). This BDC, if electing the relief and complying with the Order, would have an Adjusted Asset Coverage Ratio of 175% (190% minus 15% (25% of the difference between 190% and 130%)). As a result, the BDC would comply with the statutory asset coverage limit of 150% and be able to issue an additional 25% in leverage before reaching its statutory limit.

NOTE: The above example demonstrates a scenario where a BDCs asset coverage has fallen below its statutory limit of 150% and holds all other variables, such as investment purchases and sales, consistent since December 31, 2019. Other facts and circumstances could exist. Like the example in the Order, this example assumes the BDC has met the other conditions necessary to utilize the relief.

(2) The second focus area of the relief provided to BDCs expands on current BDC co-investment orders and allows for BDCs to co-invest with certain affiliated private funds that did not participate in the original investment, to participate in the follow-on investments.

(3) Lastly, the EP inquired whether an accounting firm may serve as an “independent evaluator” as described in the provision for the Board approval for each issuance of senior securities. The SEC IM staff noted that service providers like accounting firms might be hired by a BDC to provide such a service, and the staff would expect an accounting firm to perform an analysis of their independence for that BDC, including if they had an audit relationship with the BDC or affiliate. The staff are as always available for consultation on specific fact patterns.

3. The Commission also voted to adopt final rules related to offering reform for BDCs and CEFs, substantially as was originally proposed in May 2019. Expansion of offering reform to BDCs and CEFs was mandated by Congress in the Small Business Credit Availability Act and the Economic Growth, Regulatory Relief, and Consumer Protection Act to allow for a more streamlined registration, offering, and investor communications process.

Some key highlights of the final rule are as follows:

- *Shelf Offering Process and New Short-Form Registration Statement*
- *Ability to Qualify for Well-Known Seasoned Issuer (WKSI) Status*
- *Immediate or Automatic Effectiveness of Certain Filings*
- *Communications and Prospectus Delivery Reforms*
- *New Method for Interval Funds and Certain Exchange-Traded Products to Pay Registration Fees*
- *Periodic Reporting Requirements*
- *Incorporation by Reference Changes*
- *Structured Data Requirements*

At a high-level, the reforms essentially allow for certain eligible funds to engage in the same registration processes that have been available to operating companies since 2005 and also included changes to supplement the specific amendments mandated by Congress to align the immediately effective or automatically effective offering process long available to other types of investment funds
with the eligible funds. Lastly, the reforms also include certain disclosure requirements and new structured data requirements that will make it easier for investors and others to analyze BDC and fund data.

The rule and form amendments will become effective on August 1, 2020, with the exception of the amendments related to registration fee payments by interval funds and certain exchange-traded products, which will become effective on August 1, 2021.

In addition, the Commission is adopting compliance dates for specific requirements under the amendments to provide a transition period after the effective date of the final rule, which are described in detail here.