April 9, 2025

Client Alert

A Better Alternative: SEC Approves Simplified Version of Co-Investment Relief for Registered Closed-End Funds and BDCs

The U.S. Securities and Exchange Commission (SEC) on April 3 issued notice of its intent to grant co-investment relief (the New Relief)[1] that would be a significant modernization and simplification of the current status quo for registered closed-end funds (including interval and tender offer funds) and business development companies (collectively, Regulated Funds). The notice period will run until April 28, 2025, and barring a hearing request, relief would normally be issued on or about April 29, 2025. If granted, the New Relief would supersede the applicant's prior co-investment exemptive relief.

The SEC staff has informally indicated their expectation that once the New Relief is granted, substantially identical applications submitted by others will be reviewed and granted in an expedited manner, and a number of sponsors have already submitted such applications in anticipation of the New Relief being granted.

Background

Many Regulated Funds and their investment advisers currently rely on widely granted exemptive relief (the Current Relief)[2] that permits them to make co-investments alongside affiliates, including other private funds managed by the same investment adviser, where such investments involve the negotiation of terms other than price (negotiated co-investment transactions)[3] and would otherwise be prohibited by Sections 17(d) or 57(a)(4) of the Investment Company Act of 1940 (1940 Act) and Rule 17d-1 thereunder. Negotiated co-investment transactions are often particularly integral, for example, to the investment programs of Regulated Funds focused on direct lending and other forms of private credit strategies. The Current Relief is subject to a number of specific and fairly burdensome conditions, including the requirement that each initial co-investment, non *pro rata* follow-on investment and non *pro rata* disposition receive prior approval by a majority of the Regulated Fund's independent directors and a majority of the Regulated Fund's directors who have no financial interest in the transaction (a Required Majority), and that allocations of investment opportunities among affiliates follow a detailed procedure outlined in the Current Relief.

What's Changing?

Reduction in Board Approval Requirements	Allocation Process	Expanding Access to Follow-On Investments	Inclusion of Joint Ventures	Streamlined Board Reporting

While the New Relief will continue to require that the Regulated Funds and other affiliated entities participating in a negotiated co-investment transaction do so generally on substantially the same terms,[4] the New Relief departs significantly from the Current Relief in a number of important ways, including:

- **Reduction in Board Approval Requirements:** Under the New Relief, the board of a Regulated Fund would no longer be required to approve each initial negotiated co-investment transaction. Instead, a Regulated Fund will be permitted to participate in negotiated co-investments so long as a Required Majority of the Regulated Fund's board (1) reviews the co-investment policies of the adviser (and any other affiliates participating in the co-investment transaction not advised by the adviser) to ensure that they are reasonably designed to prevent the Regulated Fund from being disadvantaged by participation in the co-investment program; and (2) approves policies and procedures of the Regulated Fund that are reasonably designed to ensure compliance with the terms of the New Relief.

  Transaction-specific approval by a Required Majority of a Regulated Fund's board would only be required with respect to: (1) a negotiated co-investment by the Regulated Fund where an affiliate of the Regulated Fund is an existing investor but the Regulated Fund is not; (2) the Regulated Fund's participation in a non-pro rata follow-on investment; and (3) the Regulated Fund's participation in a non-pro rata disposition of an investment (except that board approval would not be required for non-pro rata dispositions of "tradeable securities," as defined in the New Relief). This streamlined board approval process will allow Regulated Funds to enter into time-sensitive transactions more efficiently and utilize board oversight more appropriately.

- **Allocation Process:** Under the New Relief, advisers will no longer be required to offer their Regulated Funds access to all negotiated co-investment opportunities (or all of such opportunities that fall within certain board-established criteria, as set forth under the Current Relief). Instead, the New Relief requires policies and procedures to be adopted that are reasonably designed to ensure that (1) co-investment opportunities are allocated in a fair and equitable manner to every Regulated Fund and (2) each participating Regulated Fund's interests are considered in the negotiation of co-investment transactions.[5] This condition avoids the need to offer, consider and report opportunities that may not be appropriate for a Regulated Fund and stops short of compelling advisers to share all co-investment opportunities, relying instead on fiduciary principles.

- **Expanding Access to Follow-On Investments:** The New Relief removes barriers that exist under the Current Relief which have prevented a Regulated Fund from participating in a co-investment where certain affiliates of the Regulated Fund, but not the Regulated

Fund itself, have a pre-existing investment (known as the “propping up” condition). Under the New Relief, a Regulated Fund would be able to participate in such follow-on investments so long as a Required Majority of the Regulated Fund’s board approves its participation in the investment.

On a related note, the New Relief also removes the restriction under the Current Relief that has prevented Regulated Funds or affiliates from participating in follow-on investments unless (1) they participated in the original co-investment and hold an investment in the issuer or, (2) in the case of follow-ons by affiliates other than Regulated Funds, they have no existing investment in the issuer at the time of the follow-on investment. Under the New Relief, both Regulated Funds and affiliates will be able to participate in follow-on investments if they have no investment in the issuer, subject to required approvals.

These points of flexibility will be particularly helpful for newly launched funds and funds that have acquired investments in secondary transactions.

- **Inclusion of Joint Ventures:** The New Relief clarifies that joint ventures formed by Regulated Funds may participate in co-investments by specifically defining joint ventures as participants in the application, removing any ambiguity that might have existed under the Current Relief.

- **Streamlined Board Reporting:** The New Relief also provides a notable reduction in the deal-by-deal information that must be presented to the boards of Regulated Funds. Under the Current Relief, Regulated Fund boards are required to be provided, on a quarterly basis, a summary review of all negotiated co-investments considered for the Regulated Fund. Under the New Relief, in contrast, each Regulated Fund’s board will receive an annual report of the Regulated Fund’s participation in negotiated co-investments, along with information regarding any material changes to how affiliated funds and advisers have decided what opportunities to allocate to the Regulated Fund.

But Not So Fast!

While the New Relief is certainly a welcome modernization, it is worth noting:

- **The door remains closed for open-end funds.** In a departure from the originally submitted application, the final version of the New Relief will not include registered open-end funds (including exchange-traded funds) within its scope.

- **Non *pro rata* follow-on investments and dispositions will still require transaction-level board approval.** While it is accurate to say that the New Relief will reduce the burden currently placed on boards, including independent directors, to approve negotiated co-investment transactions, **it is worth noting that even under the New Relief, independent directors will continue to be required to approve the involvement of their Regulated Funds in non *pro rata* follow-on investments and non *pro rata* dispositions** — two scenarios that are not uncommon in practice. Given this reality, boards should be mindful that transaction-specific approvals of co-investments will not be going away entirely.

- **Co-investments still must be in the "same class" of securities.** The New Relief continues to require that for negotiated co-investments made in reliance on the relief, all affiliates must invest in the same class of securities, which various members of the industry have previously flagged as a pain point under the Current Relief. To illustrate where this limitation might produce an undesirable result, consider a scenario where a proposed term loan investment would involve a revolving loan facility, equity kicker or other aspect that would not be permissible under or aligned with a particular Regulated Fund's strategy. In that case, either (1) the investing group would be forced to set forth a proposed deal structure that would be likely passed up in favor of the terms sought by the borrower or (2) the Regulated Fund would need to be excluded from the deal altogether, with both scenarios resulting in the likelihood that the Regulated Fund would miss out on an otherwise attractive investment opportunity.

- **Restrictions on affiliates receiving compensation remain.** The New Relief carries forward the requirement under the Current Relief that transaction fees (other than certain brokerage fees) received by affiliates must be shared pro rata among the Regulated Funds and other affiliates participating in the transaction, and that no affiliate can accept any other compensation in connection with a co-investment (with only very specific exceptions).

Next Steps

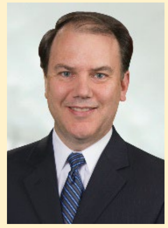
Those interested in seeking the New Relief, either as an update to the Current Relief they already rely upon or as new exemptive relief altogether, **should submit an application** for the New Relief that is substantially similar to the final, updated version submitted by the original applicants for the New Relief.

Practice Tip:

To work toward implementing the New Relief, sponsors will need to develop an approach to familiarize Regulated Fund boards with the New Relief and its processes and also develop and/or update internal processes relating to co-investments, allocations and board reporting.

For more information, contact:

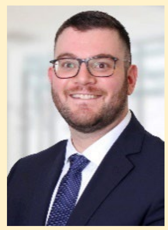
Nicole Simon
Partner and Chair, Alternative Funds
212.812.4137
nsimon@stradley.com



Michael Mundt
Partner
202.419.8403
mmundt@stradley.com

Michael O'Hare
Partner
215.564.8198
mohare@stradley.com

Eric Purple
Partner
202.507.5154
epurple@stradley.com



Jeremy Gottlieb
Associate
215.564.8123
jgottlieb@stradley.com

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[1] *FS Credit Opportunities Corp, et al.* (File No. 812-15706), Release No. IC-35520 (April 3, 2025) (notice).

[2] Although exemptive relief from the SEC must be specifically applied for and granted, a standard form of exemptive relief has emerged across the industry, with minor nuanced differences from one version of the relief to the next.

[3] Transactions where all of the affiliated parties participate on the same terms and there are no terms negotiated other than price are instead typically conducted in reliance on no-action relief granted by the SEC staff. See, e.g., Massachusetts Mutual Life Insurance Co. (pub. avail. June 7, 2000), Massachusetts Mutual Life Insurance Co. (pub. avail. July 28, 2000) and SMC Capital, Inc. (pub. avail. Sept. 5, 1995).

[4] Note that notwithstanding this requirement, under both the Current Relief and the New Relief, settlement dates may differ up to 10 business days and there is some limited flexibility with respect to the right to nominate a director or appoint a board observer for an underlying portfolio company, so long as a veto right is provided to the board of each participating Regulated Fund.

[5] The New Relief also requires that the boards of Regulated Funds be provided a copy of these co-investment policies and advised of any material changes.