

September 14, 2015

Via email: rule-comments@sec.gov

U.S. Securities and Exchange Commission  
One Station Place  
100 F Street, NE  
Washington, DC 20549

Attention: Brent J. Fields, Secretary

Re: File No. S7-12-15: Release Nos. 33-9861, 34-75342; IC-31702  
Listing Standards for Recovery of Erroneously Awarded Compensation

Dear Mr. Fields:

On behalf of the law firms listed below (the “Submitting Firms”), we are writing in response to a request for comments issued by the Securities and Exchange Commission (“Commission”) relating to the release entitled “Listing Standards for Recovery of Erroneously Awarded Compensation” (the “Proposal”), published by the Commission on July 14, 2015. The Submitting Firms routinely represent closed-end funds that have elected to be regulated as business development companies (“BDCs”) under the Investment Company Act of 1940, as amended (the “Investment Company Act”).

In the Proposal, the Commission requested comment on whether it should conditionally exempt BDCs from Rule 10D-1 under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), as it relates to certain proposed listing standards for national securities exchanges, to the same extent as it proposes to exempt registered management investment companies (“RICs”). Proposed Rule 10D-1 would require listed issuers covered by the rule to adopt, enforce, and disclose written “clawback” policies to recoup incentive-based compensation “erroneously” paid to current and former executives.<sup>1</sup> In this letter, we explain why externally managed BDCs should be treated the same as RICs, specifically registered closed-end funds, and be exempted to the same extent from proposed Rule 10D-1. Consistent with the exemption proposed by the Commission for RICs, we suggest the exemption from Rule 10D-1 for externally managed BDCs should apply only if a BDC has not awarded incentive-based compensation to any of its executive officers in the last three fiscal years (or since initial listing, if shorter) (referred to herein as a “qualifying BDC”), unless the Commission determines to make the exemption unconditional.

On July 1, 2015, the Commission proposed new rules and regulations pursuant to Section

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<sup>1</sup> Proposed Rule 10D-1, if adopted, would require each listed issuer to file its clawback policy as an exhibit to its annual report on Form 10-K. Additionally, in amendments proposed to Regulation S-K, each listed issuer would also be required to disclose certain information about any restatement that required recovery.

10D of the Exchange Act, which was added by Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. Section 10D requires the Commission to prohibit the listing of any security of an issuer that does not comply with Section 10D's requirement to disclose such issuer's policy for the recoupment from its executive officers of any incentive-based compensation received by them in excess of what they would have received after giving effect to an accounting restatement. Proposed Rule 10D-1 would require the recovery of any incentive-based compensation resulting from a material error or misstatement in a listed issuer's financial statements without regard to fault.

Proposed Rule 10D-1, if adopted, would apply to all issuers listed on a national stock exchange, with a limited exception for certain types of issuers, including RICs that have not awarded incentive-based compensation to any executive officer in the last three fiscal years (or since initial listing, if shorter) (referred to herein as "qualifying RICs"). In evaluating whether to exempt specific categories of issuers, the Commission notes that it considered whether providing exemptions from the requirements of Section 10D would be consistent with the purpose of the related statutory provision. The Submitting Firms contend that all of the reasons included in the Proposal for exempting qualifying RICs from the requirements of Section 10D apply equally to qualifying BDCs.

In the Proposal, the Commission notes that listed RICs, unlike other issuers, are typically externally managed and have few, if any, employees that are compensated by the RIC. The Proposal further notes that such RICs typically rely on employees of their investment advisers to manage the RIC's assets and carry out other related business activities and that those employees are compensated by the RIC's investment adviser rather than by the RIC itself. The Commission concludes that, while there is a small number of listed RICs that are internally managed and might pay incentive compensation to their executive officers, RICs should be subject to the requirements of proposed Rule 10D-1 to the extent they pay their executive officers equity-based incentive compensation. Accordingly, the proposed rule would exempt any listed RIC that has not awarded equity-based incentive compensation to any of its executive officers in any of the last three fiscal years or, in the case of a RIC that has been listed for less than three fiscal years, since its initial listing.

In footnote 51 of the Proposal, the Commission states that BDCs, whose purpose is to fund small and developing businesses, would not be exempted from proposed Rule 10D-1 because the legislative history regarding the adoption of the BDC-related provisions of the Investment Company Act (the "House Report") recognized the need for BDCs to be able to offer incentive-based compensation to their officers.<sup>2</sup> We respectfully submit that while such compensation is possible for an internally managed BDC, the House Report also explained the reasons why externally managed BDCs are effectively precluded from offering equity-based incentive compensation to their officers. Significantly, the House Report discussed then new clause (C) of

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<sup>2</sup> See H.R. Rep No. 1341, 96<sup>th</sup> Cong. 2d Sess. 21 (1980).

Section 205 of the Investment Advisers Act of 1940, as amended (the “Advisers Act”), which established an exemption for registered investment advisers of externally managed BDCs from Section 205’s general prohibition on performance fees based upon capital gains or capital appreciation, provided that any such incentive compensation does not exceed 20% of the BDC’s realized capital gains (net of realized capital losses and unrealized depreciation) over a period of time.<sup>3</sup> The House Report further noted that this exemption from the general prohibition on capital gains-based incentive fees was conditioned on a BDC having neither an executive compensation plan nor a profit-sharing plan as described in the new Section 61(a)(3)(B)(iii) and Section 57(n), respectively, of the Investment Company Act. This Section 205 restriction, together with the corresponding provisions of the Investment Company Act, effectively prevent an externally managed BDC from implementing an equity-based incentive compensation plan for the BDC’s officers if it pays a performance fee on capital gains or capital appreciation to its investment adviser.

Our principal positions with respect to qualifying BDCs are as follows:

**1. The exemptions for registered management investment companies as described in the Proposal are appropriate.**

In the Proposal, the Commission focuses its proposed exemptions on issuers whose structures render the application of the rule and rule amendments unnecessary.<sup>4</sup> The Submitting Firms agree with the rationales articulated by the Commission for exempting RICs from the requirements of proposed Rule 10D-1, including that an externally managed RIC typically relies on employees of its investment adviser to manage the RIC’s assets, and that such employees are typically compensated by such investment adviser rather than the RIC itself. Additionally, the Investment Company Act, the Advisers Act and related Commission regulations already impose certain legal restrictions and provide extensive legislative and regulatory oversight over incentive fees paid to investment advisers.<sup>5</sup> Because publicly traded RICs that are externally managed do not pay incentive-based compensation to their officers and generally have no employees, and their investment advisers’ compensation is subject to certain legal restrictions and extensive oversight, their structures rendered the application of proposed Rule 10D-1 and the rule amendments unnecessary.

**2. Externally managed BDCs should be treated the same as externally managed RICs.**

We strongly contend that the policy reasons for exempting RICs from proposed Rule 10D-1 apply equally to externally managed BDCs. Like externally managed RICs, externally managed

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<sup>3</sup> This exemption is now codified as Section 205(b)(3) of the Advisers Act.

<sup>4</sup> See Proposal at page 11.

<sup>5</sup> See Sections 15 and 36(b) of the Investment Company Act and Section 205 of the Advisers Act.

BDCs generally do not have employees and do not compensate their officers. Rather, an externally managed BDC typically relies on the employees of its investment adviser to manage fund assets and carry out other related business activities, and those employees are compensated by the investment adviser rather than the BDC itself. Also, as with externally managed RICs, compensation paid to the investment adviser of an externally managed BDC is regulated extensively by the Investment Company Act and the Advisers Act<sup>6</sup> and the rules and regulations thereunder. It is also subject to approval by the board of directors of the BDC, including separate approval by the BDC's independent directors, and by its shareholders at inception and in certain other circumstances.<sup>7</sup> While externally managed BDCs could theoretically offer equity-based incentive compensation plans to their officers, in practice a BDC's ability to do this is effectively prohibited by Section 205 of the Advisers Act and by Sections 57(n)(2) and 61(a)(3)(B)(iii) of the Investment Company Act,<sup>8</sup> and the Submitting Firms are not aware of any such arrangements in the market. As the Commission stated with respect to exempting RICs from the requirements of proposed Rule 10D-1, exempting BDCs that have not awarded equity-based incentive compensation would avoid causing BDCs "that do not pay incentive-based compensation to develop recovery policies they may never use."

In short, the policy concerns underlying proposed Rule 10D-1 (as they relate to externally managed BDCs) are already addressed by the existing and extensive regulatory framework applicable to externally managed BDCs.

### **3. The Commission exempted externally managed BDCs from the CEO Pay Ratio Disclosure requirements.**

Recently, the Commission issued final rules regarding CEO Pay Ratio Disclosure<sup>9</sup> (the "CEO Pay Ratio Release") and excluded externally managed BDCs from the new disclosure requirements.<sup>10</sup> In the CEO Pay Ratio Release, the Commission stated that the "final rule will apply only to BDCs internally managed such that they compensate their own employees." The CEO Pay Ratio Release further explained the Commission's rationale noting that the "employees" of externally managed BDCs are "generally compensated by the BDC's investment adviser," and not by the BDCs themselves.<sup>11</sup> The Submitting Firms submit that this same rationale supports exempting externally managed BDCs from the clawback and related disclosure requirements under proposed Rule 10D-1.

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<sup>6</sup> See *id.*; see also Sections 57(n)(2) of the Investment Company Act ("This subsection [authorizing a BDC to establish a profit-sharing plan] may not be used where the [BDC]... has an investment adviser ...") and 61(a)(3)(B)(iii) of the Investment Company Act (restricting an externally managed BDC's ability to issue options to officers among others).

<sup>7</sup> See Sections 15(a) and 15(c) of the Investment Company Act.

<sup>8</sup> See *supra* note 6 and accompanying text.

<sup>9</sup> See SEC Release No 33-9877 (August 5, 2015).

<sup>10</sup> See *id.* at page 276.

<sup>11</sup> See *id.*

## **Conclusion**

Externally managed RICs and BDCs typically have no employees, do not compensate their officers, and do not pay any incentive compensation to their officers. The compensation paid to investment advisers of externally managed BDCs, like externally managed RICs, is regulated extensively under the Investment Company Act and the Advisers Act and is subject to, among other things, separate approval by the independent directors and BDC shareholders.

Given this background, the Submitting Firms respectfully submit that externally managed BDCs should be treated no differently than externally managed RICs and be exempted from proposed Rule 10D-1. We conclude that, as with RICs, unless the exemption applicable to RICs is made unconditional in the final rules, such exemption should apply only to the extent a BDC has not awarded incentive-based compensation to any of its executive officers in the last three fiscal years (or since initial listing, if shorter).

In the event we could be useful in any way to the deliberations of the Commission or its staff on this subject, please contact any of the representatives of the signatories to this letter at the telephone numbers provided on the attached list of Submitting Firms.

[Signature Page Follows]

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Sincerely yours,

/s/ Clifford Chance US LLP  
Clifford Chance US LLP

/s/ Dechert LLP  
Dechert LLP

/s/ Fried, Frank, Harris, Shriver & Jacobson LLP  
Fried, Frank, Harris, Shriver & Jacobson LLP

/s/ Freshfields Bruckhaus Deringer US LLP  
Freshfields Bruckhaus Deringer US LLP

/s/ Proskauer Rose LLP  
Proskauer Rose LLP

/s/ Skadden, Arps, Slate, Meagher & Flom LLP  
Skadden, Arps, Slate, Meagher & Flom LLP

/s/ Sutherland Asbill & Brennan LLP  
Sutherland Asbill & Brennan LLP

/s/ Willkie Farr & Gallagher LLP  
Willkie Farr & Gallagher LLP

cc: Chairwoman Mary Jo White  
Commissioner Luis A. Aguilar  
Commissioner Daniel M. Gallagher  
Commissioner Kara M. Stein  
Commissioner Michael S. Piwowar  
Division of Investment Management Director David Grim

**List of Submitting Firms**

Clifford R. Cone, Esq.  
Andrew Epstein, Esq.  
Clifford Chance US LLP  
31 W. 52nd Street  
New York, NY 10019  
Tel: 212-878 8332  
Fax: 212 878 8375

Monica J. Shilling, Esq.  
Sandra M. Forman, Esq.  
Proskauer Rose LLP  
2149 Century Park East  
Los Angeles, CA 90067-3206  
Tel: 310-284-4544  
Fax: 310-557-2193

Thomas J. Friedmann, Esq.  
David J. Harris, Esq.  
Dechert LLP  
One International Place, 40<sup>th</sup> Floor  
100 Oliver Street  
Boston, MA 02110  
Tel: 617-728-7120  
Fax: 617-426-6567

Richard T. Prins, Esq.  
Michael K. Hoffman, Esq.  
Skadden, Arps, Slate, Meagher &  
Flom LLP  
Four Times Square  
New York, NY 10036  
Tel: 212-735-2790  
Fax: 917-777-2790

Stuart H. Gelfond, Esq.  
Jessica Forbes, Esq.  
Fried, Frank, Harris, Shriver & Jacobson LLP  
One New York Plaza  
New York, NY 10004  
Tel: 212-859-8272  
Fax: 212-859-4000

Steven B. Boehm., Esq.  
Sutherland Asbill & Brennan LLP  
700 Sixth St. #700  
Washington D.C. 20001  
Tel: 202-383-0176  
Fax: 202-637-3593

Michael Levitt, Esq.  
Paul Tropp, Esq.  
Freshfields Bruckhaus Deringer US LLP  
601 Lexington Avenue  
31<sup>st</sup> Floor  
New York, NY 10022  
Tel: 212-277-4004  
Fax: 212-277-4001

Margery K. Neale, Esq.  
Rose F. DiMartino, Esq.  
James G. Silk, Esq.  
Willkie Farr & Gallagher LLP  
787 Seventh  
Avenue New York,  
NY 10019  
Tel: 212-728-8000  
Fax: 212-728-8111