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# Co-Investment Programs: From Byzantine to Spartan

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The US Securities and Exchange Commission (SEC) is beginning to move forward on expressed agenda items to improve retail investor access to alternative investments and private markets. The SEC has expressed a desire to modernize and streamline the regulatory framework of the Investment Company Act of 1940 (1940 Act) in a manner designed to permit greater innovation by, and more efficient operation of, 1940 Act-regulated funds (1940 Act Funds). The SEC has taken action on several such projects, including by allowing privately-offered business development companies (BDCs) to issue multiple classes of shares and rescinding a Staff position that restricted 1940 Act funds from investing more than 15 percent of their assets in private equity funds and hedge funds.[1]

At the top of the modernization wish list, however, has been a more principles-based version of exemptive relief that allows 1940 Act Funds to invest alongside affiliated entities in aggregated transactions where terms of a privately placed security in addition to its price and size are negotiated (that is, co-investments). To that end, on April 29, 2025, the SEC began granting co-investment exemptive orders on terms that are substantially more flexible than existing co-investment exemptive relief. The first such order was issued for an application submitted by FS Credit Opportunities Corp. *et al.* (FS), which was substantially similar to an exemptive application originally filed by FS in April 2019 and amended in May 2019 but never granted.[2]

This new form of exemptive relief permits sponsors to establish more flexible, principles-based, and commercial co-investment programs for 1940 Act Funds that are registered closed-end investment companies (CEFs) or BDCs (together with CEFs, Regulated Funds) and should provide meaningful benefits to investors in Regulated Funds and the issuers that raise capital from fund complexes that include Regulated Funds.

## Background

At the core of the 1940 Act are broad and prescriptive rules regulating transactions with affiliates. A 1940 Act Fund's affiliates under the 1940 Act generally include, among others: (1) other 1940 Act Funds managed by the same sponsor; (2) the sponsor's private funds; (3) the sponsor's proprietary accounts; (4) companies controlled by the sponsor or its private funds and/or 1940 Act Funds (which could include, among others, insurance companies, other asset managers, real estate investment trusts, and other retail-oriented investment products); and (5) with respect to some 1940 Act Funds, companies in which the sponsor or its private funds and/or 1940 Act Funds own, control, or hold with power to vote, as little as 5 percent of the voting securities.

The SEC takes the position that, when a sponsor has both a material pecuniary incentive and the ability to cause a 1940 Act Fund to participate in a transaction, the 1940 Act may restrict the ability of the 1940 Act Fund to participate in such a transaction alongside affiliates. While no-action positions allow 1940 Act Funds to participate in most transactions in liquid securities alongside affiliates, the 1940 Act historically has been interpreted to generally prohibit the 1940 Act Fund from investing alongside its affiliates where the sponsor negotiates terms other than the price of the security (Co-Investment Transactions). However, the SEC has issued exemptive relief that generally permits Co-Investment Transactions for Regulated Funds. This co-investment exemptive relief historically has been complex, prescriptive and highly technical in application, resulting in undesirable commercial dynamics.

## Historical Development of "Co-Investment Programs"

Over time, it has become clear that there are transactions that historically have been viewed as prohibited by the 1940 Act, but which do not present the dangers of self-dealing and overreaching that the 1940 Act and its underlying rules were designed to address. For decades, the SEC and the Staff of the SEC's Division of Investment Management (Staff) have taken the position that a 1940 Act Fund should be permitted to engage in certain limited types of co-investment transactions with its affiliates without violating the 1940 Act and the rules thereunder. Since it was first adopted in 1957, Rule 17d-1 has explicitly contemplated exemptive orders that would permit otherwise prohibited co-investment transactions. In 1992, after reviewing the efficacy of existing regulation and publishing its seminal report "Protecting Investors: A Half Century of Investment Company Regulation," (Protecting Investors Report) the Staff went so far as to recommend that Rule 17d-1 be amended to permit certain joint transactions where a registered fund participates on the same terms as its affiliates.[3]

In recent decades, the Staff has taken no-action positions and issued exemptive orders to facilitate certain categories of co-investment transactions for certain types of 1940 Act Funds, consistent with the recommendations it gave in the Protecting Investors Report. In general, the Staff continued to impose protective conditions intended to address the potential conflicts that arise if the sponsor has both a material pecuniary incentive and the ability to cause the 1940 Act Fund to participate in the transaction. Accordingly, the Staff developed no action positions for certain categories of transactions that do not raise these concerns. Specifically, in the "*Mass Mutual*" line of no-action letters, the Staff took no action positions for joint transactions in which no terms are negotiated other than price, and allocations of opportunities are made fairly and pursuant to policies approved by the board of the 1940 Act Fund.[4] The Staff's position is that, under such circumstances, there are no negotiations through which affiliates could manipulate the terms of the investment and potentially place a 1940 Act Fund at a disadvantage relative to another client, so the transaction does not pose the risks of overreaching that the 1940 Act and its rules were designed to address.

For joint investment opportunities that involve negotiation of terms other than price, the SEC has required 1940 Act Funds to request specific relief through the exemptive order process. Once 1940 Act Funds and their affiliates receive an exemptive order, they can operate a "Co-Investment Program" to enter into transactions that involve negotiation of terms other than price subject to the conditions set forth in their exemptive application and order.

## Conditions to Relief

Co-investment-related exemptive orders historically have imposed more than a dozen conditions on Co-Investment Programs that restrict how the funds and advisers identify, enter into, allocate, and approve Co-Investment Transactions, and dictate how a fund's board must monitor and oversee the Co-Investment Program. While some aspects of co-investment exemptive applications evolved over time and thus differ between applicants, there are several elements of each Co-Investment Program that are generally consistent across the Regulated Funds industry.

### Same Class, Same Terms

One key condition that appears in all co-investment exemptive applications is that all participants in Co-Investment Transactions must invest in the same class or classes of securities, on the same terms and at the same time.[5] This condition is designed to mitigate the concern of overreaching—that is, that a Regulated Fund could be disadvantaged relative to its affiliates with respect to a specific transaction. While this policy objective is well-intentioned, it can result in situations where a 1940 Act Fund is forced to invest in certain classes of securities that it would not otherwise invest in absent this condition, and it can preclude affiliated entities that are not permitted to invest in certain parts of an issuer's capital structure from participating in a Co-Investment Program.

### Significant Limits on Co-Investments with an Existing Affiliated Position

One of the most difficult conditions of the historical co-investment relief is that, subject to certain limit exceptions contained in certain newer orders, Regulated Funds only can participate in an initial Co-Investment Transaction in an issuer if there are no affiliated entities currently invested the issuer. This has made it substantially more difficult for new Regulated Funds to find deal flow and to participate in favorable transactions with companies that are well known to, and well understood by, the sponsor.

### Transaction Fees and Other Compensation

Affiliates must share transaction fees pro rata (including fees received in connection with the right of one or more Regulated Funds or affiliates to nominate a director or appoint a board observer or otherwise to participate in the governance or management of the portfolio company) and cannot accept other compensation related to participation in a co-investment transaction, except (1) brokerage or underwriting compensation permitted by Section 17(e) or 57(k) of the 1940 Act or (2), in the case of the advisers, investment advisory compensation paid in accordance with investment advisory agreements between the applicable Regulated Fund or affiliate and its adviser.

### Allocation of Opportunities

Another key condition of early exemptive orders is that Co-Investment Transactions considered for affiliated funds in the Co-Investment Program also must be considered for a Regulated Fund if the transaction falls within the Regulated Fund's then-current investment objectives and strategies.[6] For example, if an adviser is considering a Co-Investment Transaction opportunity for an affiliated private fund or one specific Regulated Fund in the Co-Investment Program, it must also consider whether the opportunity would be appropriate for all other Regulated Funds that participate in the Co-Investment Program. This condition exists to ensure that Regulated Funds are not simply brought in to participate on less lucrative deals, or to provide additional capital when a deal is undersubscribed, but instead have full access to any deals available to the other affiliated entities participating in the Co-Investment Program. However, it can be difficult to implement in large organizations with multiple investment teams implementing overlapping investment mandates.

### Additional Transactions

In addition to governing initial Co-Investment Transactions, Co-Investment Programs also govern the process by which participants dispose of the interests they acquire in Co-Investment Transactions, as well as any follow-on opportunities to invest in an issuer after an initial Co-Investment Transaction. In this regard, Co-Investment Programs also set forth conditions with respect to the scope and process of deal-sharing for both dispositions and follow-on investments.

### Sizing of Positions

Once the participants decide whether to participate in a Co-Investment Transaction and have indicated their desired participation levels (as determined by the adviser to each participant), the opportunity is allocated accordingly. If the demand for the opportunity from participants exceeds what is available to the manager as a whole, the investment opportunity is allocated among all of the co-investing entities on a pro rata basis, based on criteria specific to each Co-Investment Program.

### Board Approval

Once the adviser to the Regulated Fund has determined that it should participate in a Co-Investment Transaction, it must seek approval from the "Required Majority" of the Regulated Fund's board, meaning "both a majority of a [Regulated Fund's] directors or general partners who have no financial interest in [the transaction] and a majority of such directors or general partners who are not interested persons of such [Regulated Fund]." The Required Majority of the Regulated Fund's board must find that

> (i) the terms of the transaction, including the consideration to be paid, are reasonable and fair to the Regulated Fund and its equity holders and do not involve overreaching in respect of the Regulated Fund or its equity holders on the part of any person concerned; (ii) the transaction is consistent with: (A) the interests of the Regulated Fund's equity holders; and (B) the Regulated Fund's then-current Objectives and Strategies; (iii) the investment by any other Regulated Fund(s) or Affiliated Fund(s) would not disadvantage the Regulated Fund, and participation by the Regulated Fund would not be on a basis different from, or less advantageous than, that of any other Regulated Fund(s) or Affiliated Fund(s) participating in the transaction…

## Evolving Co-Investment Programs

For many years, all Co-Investment Programs followed a similar template, with certain variations that were driven by the increasing complexity of many asset management firms. Over time, standardized conditions proved to be unworkable for many of the most successful asset management firms. Such firms often have multiple advisers with a variety of 1940 Act Funds and private funds, and the conditions imposed under the standard form of exemptive relief require substantial amounts of information to be shared between affiliates and an exceedingly complex compliance framework to manage the associated regulatory obligations.

A "next generation" of Co-Investment Programs began with an order granted to Apollo Investment Corporation and its affiliates (Apollo) in 2016.[7] After years of negotiation with the Staff, Apollo was successful in seeking a more scalable and flexible approach than had been historically granted. One notable modification that arose out of this new generation of relief was to add a mechanism that allowed the board of a Regulated Fund to set criteria that would limit the range of transactions that must be presented to that Regulated Fund. As fund investment strategies often are broadly worded to provide flexibility, the ability to establish criteria to narrow the types of opportunities that are the most likely to be appropriate for a Regulated Fund significantly reduced the administrative burden on the adviser of documenting why a Regulated Fund declined to participate in opportunities that are unlikely to fit its core strategy or target risk/return profile.[8] The line of applications that have adopted this mechanism refer to this concept as "Board-Established Criteria."[9]

This new generation of relief also added the flexibility to allow for certain very limited disposition and follow-on transactions under the co-investment order with respect to initial investments that were not made under the Co-Investment Program.[10] The newer applications that include this flexibility refer to these as "enhanced review" dispositions and follow-ons. The SEC issued dozens of co-investment exemptive orders after Apollo's was granted in 2016 and prior to the "3.0" version of orders the SEC began to issue in April 2025. As the SEC and the industry grappled with the complexities of modern asset management firms, revising the "standard" set of conditions for a Co-Investment Program has resulted in a patchwork of exemptive applications with varying representations, conditions and requirements as each applicant attempts to find a workable solution for its business model.

## Relief for Negotiated Follow-On Investments

Under existing exemptive relief precedent, a Regulated Fund and its affiliates could jointly negotiate a co-investment in an issuer only if no affiliated issuer had an existing position in the issuer, but if a negotiated follow-on opportunity arose, other affiliated funds would not be able to participate unless they were part of the initial co-investment. During the COVID pandemic, the SEC provided additional co-investment flexibility that allowed a BDC to rely on an existing order to participate in such follow-on investments alongside affiliated private funds that did not currently hold an interest in the issuer.[11] This temporary exemptive relief meant that a sponsor, when considering whether to refinance the existing debt of, and/or provide additional financing to, a BDC portfolio company, would have access to additional private pools of capital to support such financing. This flexibility is particularly important when a sponsor raises a new draw down private fund to replace an earlier vintage that is nearing the end of its investment period. The SEC extended this temporary flexibility and later approved amended co-investment orders incorporating this new relief for all Regulated Funds as a permanent fixture of existing Co-Investment Programs.[12]

## Key Improvements and Simplifications for 2025

As noted earlier, on April 29, 2025, the SEC began granting co-investment exemptive orders on terms that are substantially more flexible than existing co-investment exemptive relief. The following subsections explain how the new terms of the new orders compare to the typical practices under prior exemptive orders.

### Streamlined Investment Allocations

**Prior Practice:** Under prior co-investment relief, all potential Co-Investment Transactions that aligned with a Regulated Fund's investment objectives and strategies, and that were within a Regulated Fund's "board-established criteria" for co-investment opportunities, had to be offered to the Regulated Fund. This often required investment advisers to deviate from their standard investment allocation processes, which created an unnecessary administrative burden and constrained an adviser's ability to allocate investment opportunities in the manner most beneficial to all of its clients.

**New Relief:** The new relief will require investment advisers (and any affiliate relying on the relief that is not advised by an adviser) to adopt allocation policies that are reasonably designed to ensure that the adviser negotiating a Co-Investment Transaction considers the interest in the transaction of any participating Regulated Fund and that opportunities to participate in Co-Investment Transactions are allocated in a manner that is fair and equitable to every Regulated Fund participating in the co-investment program. This revised standard should allow an investment adviser to adopt a more principles-based approach to determine how to allocate potential co-investment opportunities in an equitable manner across all clients managed by a particular investment team without imposing the prescriptive process contained in existing co-investment relief.

### Modernizing the "Propping Up" Condition

**Prior Practice:** Under prior co-investment relief, a Regulated Fund generally could not participate in an initial Co-Investment Transaction if any affiliates had a pre-existing investment in the issuer and the Regulated Fund did not. This prohibition was based on the concern that a later-in-time investment by a Regulated Fund could be used to "prop up" earlier investments by affiliated entities, but in practice it often prevented Regulated Funds, particularly new products, from investing in attractive opportunities with issuers that were well known by the sponsor. Moreover, the prohibition, without even a *de minimis* exception, failed to recognize that many large asset managers have business units that invest in different types of investments, and thus unduly precluded a Regulated Fund from investing in many portfolio companies where its affiliate's preexisting investment did not present the risks of overreaching that the prohibition on joint transactions was intended to address.

The prior co-investment relief also limited the ability of Regulated Funds, private funds, and other affiliated entities to participate in follow-on transactions. Among other issues, (1) new Regulated Funds could not be added to an older deal, and (2) entities that acquired a position in the issuer outside of the co-investment order (for example, through a season and sell process or other subsequent secondary transaction) arguably could not participate in follow-on transactions without following the same process in connection with the follow-on transaction. This has meaningfully constrained the ability of Regulated Funds to participate fully, or participate at all, in attractive follow-on opportunities where their sponsor's other clients were an incumbent investor.

**New Relief:** The new relief permits a Regulated Fund's Required Majority to approve participation in investments where an affiliate relying on the relief has an existing position in the issuer, even if the Regulated Fund does not. Relatedly, the new relief eliminates entirely the concept of a "follow-on investment" and simply treats all Co-Investment Transactions as individual transactions that need to meet the requirements of the co-investment relief. The new relief applies a simple rule that Required Majority approval is required for a Regulated Fund's participation in each Co-Investment Transaction in an issuer in which an affiliate relying on the relief has an interest unless (1) the Regulated Fund already holds the same security as such affiliates, and (2) the Regulated Fund and such affiliates participate on a basis that is in approximate proportion to each of their then-current holdings.

Specifically, if board approval is required under the new relief, the Required Majority must find that:

- The terms of the Co-Investment Transaction are reasonable and fair to the shareholders or partners of the Regulated Fund and do not involve overreaching of the Regulated Fund or its shareholders or partners on the part of any person concerned; and
- The proposed transaction is consistent with the interests of the shareholders or partners of the Regulated Fund and is consistent with the policy of the Regulated Fund as recited in its public filings and shareholder reports.

The board members must record in their meeting minutes and preserve in their records a description of the Co-Investment Transaction, their findings, the information or materials upon which their findings were based, and the basis therefor.

This new provision for Required Majority approval of co-investments where an affiliate relying on the relief has an existing position in the issuer should allow Regulated Funds to access a significantly broader array of investment opportunities, including attractive deals where a sponsor has the benefit of extensive experience with the operations of the issuer. It also should greatly improve the ability of newly launched Regulated Funds to access attractive investment opportunities, and could provide a smoother ramp period into core alternatives strategies.

### Reduced Frequency of Board Approval:

**Prior Practice:** Approval by the Required Majority was required for (1) every new co-investment involving a Regulated Fund, and (2) every follow-on investment or disposition involving a

Regulated Fund, unless the transaction was allocated pro rata among the participants or involved tradeable securities. For asset management groups with an active alternative investment strategy, this requirement imposed a significant burden on boards of participating Regulated Funds, with board members frequently called on to review and consider the approval of many time sensitive co-investment opportunities between regularly scheduled meetings.

**New Relief:** As described above, approval by the Required Majority will be necessary only for acquisitions or dispositions made in reliance on the relief if an affiliate relying on the relief has an existing investment in an issuer and the Regulated Fund either does not have an investment in the same securities of the issuer or is not participating pro rata with all other affiliates relying on the relief and holding such securities. This change should serve to focus a Regulated Fund board's attention on transactions with more significant potential for conflicts.

### More Categories of Affiliates Can Benefit from Participation in the Co-Investment Program

**Prior Practice:** Prior co-investment orders typically covered BDCs, CEFs, and private funds or other pooled investment vehicles relying on Sections 3(c)(1), 3(c)(7), 3(c)(5)(C) or Rule 3a-7 under the 1940 Act advised by the adviser or an affiliate, along with certain controlled fund vehicles and proprietary accounts.

**New Relief:** The new orders extend eligibility to several important categories of entities:

- Affiliates of an adviser and any direct or indirect, wholly- or majority-owned subsidiary of an adviser or its affiliates (including, for instance, operating company conglomerates and employees' securities companies, but not including open-end investment companies).
- Regulated Funds sub-advised by a sponsor where the primary adviser is unaffiliated with the sponsor.
- Unconsolidated joint venture subsidiaries and controlled portfolio companies of Regulated Funds.
- Any entity that would be an investment company but for Section 3(c) under the Investment Company Act of 1940 or Rule 3a-7 thereunder (that is, not only entities relying on Sections 3(c)(1), 3(c)(5)(C), and 3(c)(7)).

Notably, the new relief does not extend to 1940 Act Funds that are open-end investment companies (that is, mutual funds or ETFs); therefore, these types of 1940 Act Funds still cannot directly participate in Co-Investment Transactions with affiliates in reliance on the co-investment order.

### Principles-Based Reporting and Compliance Regime

**Prior Practice:** Quarterly reports to the board were required, with technical, prescriptive requirements that detailed, among other things, all co-investments not offered to a Regulated Fund, follow-ons, dispositions, and declined investments.

**New Relief:** The new orders instead allow a Regulated Fund's board to determine the format and content of quarterly reports regarding the Co-Investment Program. In addition, each Regulated Fund's investment adviser and chief compliance officer (CCO) must provide a summary of significant compliance matters, and the adviser and CCO must supply an annual report covering the Regulated Fund's participation in the Co-Investment Program and any material changes in the investment adviser's policies or affiliate participation.

## Initial Interpretive Questions

The new form of co-investment application provides useful flexibility, as described above. However, due to the complexity of Co-Investment Transactions and the stringent nature of the prohibitions under the 1940 Act, along with related rules and SEC guidance, interpretive questions remain.

### "No remuneration" Clause: What Transaction-Related Fees Are Permissible, and When Must They Be Shared Pro Rata among Transaction Participants?

Both the historical and new forms of the Co-Investment order limit the transaction-related fees that can be received by affiliates. However, the changes to the transaction fee-related condition in the new order include provisions that are less restrictive than the prior version of exemptive relief.[13]

As noted above, the prior form of the "no remuneration" condition prohibited the receipt of additional remuneration or compensation "as a result of or in connection with a Co-Investment Transaction." In contrast, the updated "no-remuneration" condition removes the phrase "as a result of," and is limited by its terms to compensation received "in connection with a *Regulated Fund's* participation in" a Co-Investment Transaction (emphasis added). Accordingly, there is a significant interpretive question as to whether many financial benefits that could arise in a transaction are received "in connection with a Regulated Fund's participation in" a co-investment transaction.

What is clear from the change, however, is that affiliates can earn compensation, remuneration, or financial benefits from a Co-Investment Transaction to the extent such financial benefits stem from the participation of non-Regulated Fund affiliates. Importantly, this includes allowing an affiliate to receive placement fees from affiliated funds and third parties in amounts exceeding the 1 percent limit applicable to Regulated Funds under Sections 17(e) and 57(k).

### Board Approval: How Much Variation Between the Allocation to a Regulated Fund and an Affiliate Would Qualify As the "Approximate Proportion" to Their Then-Current Holdings?

The new co-investment exemptive relief imposes board approval requirements under certain circumstances to protect the interests of the Regulated Fund and minimize the risk of overreaching. In one such instance, the orders require pre-investment board approval for transactions where affiliates relying on the relief already hold securities of the issuer and the interests in the transaction will be allocated in a manner other than pro rata based on the Regulated Fund's and such Affiliates' pre-transaction holdings.[14] The new form of application, however, states that a Regulated Fund does not need to seek board approval for Co-Investment Transactions that are allocated to a Regulated Fund and each such affiliated entity "in approximate proportion to its then-current holdings." The addition of the phrase "in approximate proportion" introduces an interpretive question as to the level of variation that would require board approval.

Variations from strict pro rata participation introduce the concern that some participants may be inappropriately "bailing out" other participants from prior underperforming investments or, conversely, "boxing out" other participants from promising future returns.[15] In view of these conflicts, the phrase "approximately pro rata" in the pre-investment board approval condition is likely a means to accommodate fractional shares, odd lots, or other undesirable operational and accounting outcomes that could result from a strict pro rata allocation. Through that lens, an immaterial difference of 0.50 percent among parties, and which does not materially alter the economics of the transaction, could be viewed as a reasonable threshold; however, given that the alternative is simply board approval, we expect that most sponsors will weigh the certainty of that board approval against the risk of taking an interpretive position in circumstances where variations from strict pro rata are not driven by addressing operational issues such as fractional shares and odd lots.

### When the Approval of the Required Majority Is Required, What Information Should Be Provided to the Board in Support of the Required Findings?

The standard for board approval of co-investment transactions has remained similar through the evolution of exemptive orders, consistent with the Staff's position in the Protecting Investors Report that such approval should follow the approach in Section 57(f) of the 1940 Act (that is, the approval of the Required Majority should be supported by findings that the terms of the transaction are reasonable and fair and consistent with the interests of the Regulated Fund and its shareholders).[16] At a minimum, a Regulated Fund's sponsor should prepare materials that are sufficient to establish a record in support of the required findings under Section 57(f). Accordingly, the materials should establish that the allocation is appropriate for the Regulated Fund, is aligned with the adviser-level policies adopted pursuant to Condition 5 of the application, and should explain any conflicts of interest that may arise from the transaction. High level supporting facts about the terms of the transaction and the participation of the Regulated Funds and affiliates should be included in the record and can help support the Required Majority in making the required findings that the Co-Investment Transaction is reasonable and fair to the shareholders of the Regulated Fund, does not involve overreaching of Regulated Fund or its shareholders, and is consistent with the interests of the shareholders of the Regulated Fund.

### The Co-Investment Relief Defines an "Affiliated Entity," in Part, as an Entity "That Intends to Engage in Co-Investment Transactions." If a Sponsor Manages Entities That Do Not Intend to Engage in Co-Investment Transactions, Do Those Entities Fall Outside the Scope of the Application and Its Conditions?

The definition of "Affiliated Entity" in the new co-investment relief is cabined to cover those entities that intend to enter into Co-Investment Transactions.[17] Accordingly, the exemptive relief covers entities and transactions that may implicate the conflicts of interest that the affiliated transactions provisions of the 1940 Act were designed to address. The exemptive order, and the applicable provisions of the 1940 Act, do not apply to entities that do not intend to enter into affiliated transactions in reliance on the co-investment relief. As a general guideline, any entity named in the exemptive order application presumably intends to engage in Co-Investment Transactions, and should be subject to the order, and the compliance policies adopted pursuant to the order should scope in any other entities that have subsequently formed an intent to engage in Co-Investment Transactions.

### The Application Requires Each Regulated Fund's Adviser and Chief Compliance Officer to Provide a Regulated Fund's Board with a Quarterly Summary of Matters "Deemed Significant" Relating to the Implementation of the Policies and Procedures Related to the Co-Investment Program. What Sort of Matters Would Be Significant Enough to Warrant Reporting to the Board under This Provision?

While the scope of this requirement is not clearly defined, the adviser and/or chief compliance officer to a Regulated Fund should consider reporting any material conflicts of interest that develop over the course of the reporting period (for example, material new business lines that will co-invest), and material changes to the policies that are required to be established under the application. Each of these types of matters are at the core of what the 1940 Act and the co-investment exemptive relief are designed to address, so material changes in any of those areas might be "deemed significant" from a policy perspective. However, changes to policies that are not required by the exemptive order, and disclosure updates that are not related to affiliated transactions, do not raise the same policy concerns and are less likely to be "deemed significant" for board reporting purposes.

## What's Next: Implementation

The process of aligning with the new exemptive relief requires a series of comprehensive updates and revisions to various policies and documents. Here is a high level list of implementation steps for an asset manager that plans to adopt the new relief:

- **Draft co-investment policies for advisers and affiliated entities without advisers:** The new relief mandates the adoption and board review of policies and procedures for the Regulated Funds and the Advisers as specified under Conditions 5 and 7(b)(i). These policies must be completed and implemented before relying on the new order. This step is crucial to ensure compliance and to outline the procedures and principles that will govern co-investment activities.
- **Revise allocation policies:** Existing allocation policies should be revised to align with the more principles-based approach outlined in the new order. This revision can be integrated into the adoption of the adviser policies mentioned above. Additionally, new entities that are now covered by the order may require specific considerations and adjustments. All revisions should be finalized and implemented before relying on the new order.
- **Update regulated fund compliance manuals:** The compliance manuals for regulated funds should be updated to reflect the new form of the order and the requirements under Condition 7(b)(ii). This includes revising the 38a-1 policies to ensure they are in line with the new regulatory framework. These updates should be completed prior to relying on the new order.
- **Consider updates to board-established criteria or develop enhancements to investment adviser allocation policies:** It remains important for fund sponsors to evaluate how opportunities will be shown and allocated to Regulated Funds under a Co-Investment Program. While some sponsors may wish to retain the concept of board-established criteria, the new form of application provides greater flexibility for a sponsor to design an allocation process that is workable for the sponsor's unique business and meets the standard for fair and equitable allocations. This evaluation ideally should be completed prior to relying on the new order, though it can also be rolled out and iterated on over time if necessary.
- **Update Form ADV:** The conflicts disclosure section in Form ADV should be revised to reflect the changes introduced by the new order. This update should be completed during the next regular update cycle to ensure that all relevant information is accurately and timely disclosed to regulators and investors.
- **Update conflicts/risk disclosure in fund offering documents and periodic reports:** Conflicts and related disclosures in various fund documents should be updated to align with the new order. This includes registration statements, private placement memoranda, and periodic reports. These updates should be rolled out during the regular update cycles for each fund to maintain transparency and compliance.
- **Consider desired updates to quarterly board reporting:** The principles-based approach under Condition 7(c) of the new order may necessitate changes to the quarterly reporting by the adviser and CCO. These updates can be made prior to relying on the new order or gradually implemented over time, ensuring that the board receives accurate and relevant information.
- **Consider desired updates to annual board reporting:** Similarly, the annual reporting by the adviser and CCO may need to be adjusted to reflect the principles-based requirements under Condition 7(d) of the new order. These updates can be made prior to relying on the new order or gradually implemented over time, ensuring that the board receives accurate and relevant information.
- **Consider board presentation/training:** A Regulated Fund's board may request a training to explain how their roles and responsibilities will change under the new order, particularly if the board did not receive a comprehensive

presentation during the exemptive application process.

- **Arrange for training for business and legal personnel on new order conditions:** Training sessions should be organized for key departments, including legal, compliance, and portfolio management, to ensure they understand the new order conditions and can implement them effectively.

## Room for Improvement

While the new relief is a welcome step forward, there are several remaining issues that would benefit from further engagement with the SEC:

- **Same Terms and Classes of Securities**
  - **Current Requirement:** Affiliates must invest on the same terms and in the same classes of securities.
  - **Potential Improvement:** Greater flexibility could allow affiliates to participate in different parts of the capital structure. To mitigate potential conflicts, co-investments in different parts of the capital structure could require supplementary board approval and reporting.
- **Compensation Restrictions**
  - **Current Requirement:** Affiliates must share transaction fees pro rata and cannot accept other compensation related to a Regulated Fund's participation in a co-investment transaction, except (1) brokerage or underwriting compensation permitted by Sections 17(e) or 57(k) of the 1940 Act or (2) advisory compensation.
  - **Potential Improvement:** Co-investment transactions can be financially complex, particularly when a transaction is designed to provide financial support in a specific part of an issuer's capital structure or during a particular stage of an issuer's business cycle. Different types of entities can provide value when they source and manage complicated investments. Co-investment relief could be revised to reflect these market realities and allow for compensation for these valuable services while still preventing conflicts of interest and protecting investors.
- **Tailored Relief for Principal Transactions**
  - **Current Requirement:** The principal transaction prohibitions of the 1940 Act frequently prevent affiliates in a co-investment program from entering into follow-on investments in issuers that become affiliated due to the initial co-investment transaction. For example, if affiliates in a co-investment program make a substantial equity investment in an issuer, the issuer may become an affiliate of the Regulated Funds in the co-investment program by virtue of their equity ownership stake from the initial co-investment transaction. Accordingly, the 1940 Act restrictions on principal transactions prevent Regulated Funds in the co-investment program from making follow-on investments in the now-affiliated issuer when an exemption from the principal transaction prohibitions is not available.
  - **Potential Improvement:** The current principal transaction framework is a major constraint to retail investors' access to certain investment strategies, such as private equity or infrastructure, that seek to make control investments or exert technical control over portfolio companies. Future relief could provide targeted exemptions from the 1940 Act prohibition on principal transactions to facilitate follow-on investments in issuers that become affiliates of the Regulated Funds.

## Conclusion

Affiliated transactions will always raise significant considerations under the 1940 Act. However, the evolving regulatory framework for affiliated transactions shows that the SEC and market participants can negotiate appropriate methods to reduce the potential for conflicts while promoting innovation and capital formation. The SEC's new co-investment exemptive orders are the product of substantial long-term engagement between asset managers and the SEC Staff, and the updated conditions are a significant step forward to simplify processes and reduce barriers for 1940 Act Funds and affiliated entities. However, there are still important interpretive questions and potential improvements, and continued engagement that addresses these remaining items would benefit investors, asset managers, and the issuers that raise capital from Co-Investment Programs.

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## NOTES

1 For an example of a multi-class application and order for a privately-offered BDC, *see* Jefferies Credit Management LLC, *et al.*, (File No. 812-15016) (Amended application filed March 14, 2025; Order granted on April 9, 2025). For a description of the SEC Chairman's view of whether to impose a 15 percent limit on registered closed-end fund investments in private funds as of May 2025, *see* Paul S. Atkins, Chairman, Prepared Remarks Before SEC Speaks (May 19, 2025) (available at *https://www.sec.gov/newsroom/speeches-statements/atkins-prepared-remarks-sec-speaks-051925*).

2 Initial Application: FS Global Credit Opportunities *et al.*, Application for an Order Pursuant to Sections 17(d) and 57(i) of the Investment Company Act of 1940 and Rule 17d-1 under the Investment Company Act of 1940 Permitting Certain Joint Transactions Otherwise Prohibited by Sections 17(d) and 57(a)(4) of and Rule 17d-1 under the Investment Company Act of 1940 (File No. 812-15016) (filed April 3, 2019).

Amended Application: FS Global Credit Opportunities *et al.*, Amendment No. 1 to the Application for an Order Pursuant to Sections 17(d) and 57(i) of the Investment Company Act of 1940 and Rule 17d-1 under the Investment Company Act of 1940 Permitting Certain Joint Transactions Otherwise Prohibited by Sections 17(d) and 57(a)(4) of and Rule 17d-1 under the Investment Company Act of 1940 (File No. 812-15016) (filed May 10, 2019).

3 SEC Division of Investment Management, Protecting Investors: A Half Century of Investment Company Regulation (May 1992) (the Protecting Investors Report) at Chapter 12, Section III.B.2.

4 Mass Mutual Life Insurance Company, SEC No-Action Letter, publicly available June 7, 2000 (available at *https://www.sec.gov/divisions/investment/noaction/2000/massmutuallife060700.pdf*). *See also* Mass Mutual Life Insurance Company, SEC No-Action Letter, publicly available July 28, 2000 (available at *https://www.sec.gov/divisions/investment/noaction/2000/massmutuallife072800.pdf*) (declining to express a view as to joint transactions in which a fund sponsor does not participate or have a material pecuniary interest in an entity that does participate but negotiates the terms of the transaction).

5 A common formulation of the "same terms" condition is that a Regulated Fund may not participate in a Co-Investment Transaction "unless the terms, conditions, price, class of securities to be purchased, settlement date and registration rights will be the same" for the Regulated Fund and its affiliates.

6 The standard scope of the definition of "Objectives and Strategies" includes the Regulated Fund's investment objectives and strategies as described in the fund's registration statement and shareholder reports or as described in filings made under the Securities Act of 1933, as amended, or under the Securities Exchange Act of 1934, as amended.

7 Apollo Investment Corporation, *et al.*, Order under Sections 17(d) and 57(i) of the Investment Company

Act of 1940 and Rule 17d-1 under the Act, Release No. 32057, March 29, 2016.

8 Apollo Investment Corporation, *et al.*, Amendment No. 7 to Application for an Order Pursuant to Sections 17(d) and 57(i) of the Investment Company Act of 1940 and Rule 17d-1 under the Act to Permit Certain Joint Transactions Otherwise Prohibited by Sections 17(d) and 57(a)(4) of the Act and Rule 17d-1 under the Act (File No. 812-13754) (filed March 1, 2016) (hereinafter, the Apollo Application).

9 *See* condition 1(a) of the Apollo Application, *supra* n.8.

10 *See* conditions 7 and 9 of the Apollo Application, *supra* n.8.

11 SEC Release No. 33837 (April 14, 2020) (*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*).

12 SEC Division of Investment Management, Division of Investment Management Coronavirus (COVID-19) Response FAQs, Question III.1. (Modified April 22, 2021) (available at SEC.gov | Division of Investment Management Coronavirus (COVID-19) Response FAQs).

13 The "No Remuneration" condition is as follows: "Any transaction fee* (including break-up, structuring, monitoring or commitment fees but excluding broker's fees contemplated by Sections 17(e) or 57(k) of the 1940 Act, as applicable), received by an Adviser and/or a Participant in connection with a Co-Investment Transaction will be distributed to the Participants on a pro rata basis based on the amounts they invested or committed, as the case may be, in such Co-Investment Transaction. If any transaction fee is to be held by an Adviser pending consummation of the transaction, the fee will be deposited into an account maintained by the Adviser at a bank or banks having the qualifications prescribed in Section 26(a)(1) of the 1940 Act, and the account will earn a competitive rate of interest that also will be divided pro rata among the Participants based on the amount they invest in such Co-Investment Transaction. No Affiliated Entity, Regulated Fund, or any of their affiliated persons will accept any compensation, remuneration or financial benefit in connection with a Regulated Fund's participation in a Co-Investment Transaction, except: (i) to the extent permitted by Sections 17(e) or 57(k) of the 1940 Act; (ii) as a result of either being a Participant in the Co-Investment Transaction or holding an interest in the securities issued by one of the Participants; or (iii) in the case of an Adviser, investment advisory compensation paid in accordance with investment advisory agreement(s) with the Regulated Fund(s) or Affiliated Entity(ies)."

*"Applicants are not requesting and the [SEC] is not providing any relief for transaction fees received in connection with any Co-Investment Transaction."

FS Credit Opportunities Corp., *et al.*, Amendment No. 3 to the Application for an Order Pursuant to Sections 17(d) and 57(i) of The Investment Company Act of 1940 and Rule 17d-1 under the Investment Company Act of 1940 Permitting Certain Joint Transactions Otherwise Prohibited by Sections 17(d) And 57(a)(4) of and Rule 17d-1 under the Investment Company Act of 1940 (File No. 812-15706) (filed Apr. 3, 2025) [hereinafter Application 3.0], Condition 4.

14 Prior to a Regulated Fund acquiring in a Co-Investment Transaction a security of an issuer in which an Affiliated Entity has an existing interest in such issuer, the Required Majority will take the steps set forth in Section 57(f) of the 1940 Act,* unless: (i) the Regulated Fund already holds the same security as each such Affiliated Entity; and (ii) the Regulated Fund and each other Affiliated Entity holding the security is participating in the acquisition in approximate proportion to its then-current holdings.

*Section 57(f) provides for the approval by a Required Majority of certain transactions on the basis that, in relevant part: (i) the terms of the transaction, including the consideration to be paid or received, are reasonable and fair to the shareholders of the BDC and do not involve overreaching of the

BDC or its shareholders on the part of any person concerned; (ii) the proposed transaction is consistent with the interests of the BDC's shareholders and the BDC's policy as recited in filings made by the BDC with the [SEC] and the BDC's reports to shareholders; and (iii) the BDC's directors record in their minutes and preserve in their records a description of the transaction, their findings, the information or materials upon which their findings were based, and the basis for their findings.

Application 3.0, *supra* n.13, Condition 2.

15 Note that Participants continue to be permitted to engage in non-negotiated co-investments outside of the scope of the Application under the Mass Mutual line of no-action letters if the non-negotiated Co-Investment is allocated in a fair manner, pursuant to policies approved by the board of the 1940 Act Fund.

16 Protecting Investors Report at Chapter 12, Section III.B.1; Application 3.0, *supra* n.13, Conditions 2 and 6.

17 "Affiliated Entity" means an entity not controlled by a Regulated Fund that intends to engage in Co-Investment Transactions and that is (a) with respect to a Regulated Fund, another Regulated Fund; (b) an Adviser or its affiliates, and any direct or indirect, wholly- or majority-owned subsidiary of an Adviser or its affiliates, that is participating in a Co-Investment Transaction in a principal capacity; or (c) any entity that would be an investment company but for Section 3(c) of the 1940 Act or Rule 3a-7 thereunder and whose investment adviser is an Adviser. To the extent that an entity described in clause (b) is not advised by an Adviser, such entity shall be deemed to be an Adviser for purposes of the conditions. Application 3.0, *supra* n.13, footnote 7.