Important Information about Business Development Companies

Baird has prepared this document to help you understand the characteristics and risks associated with an investment in securities of a business development company ("BDC"), so that you can make an informed decision when buying or selling these securities. BDCs can be speculative investments because of the types of investments they make and involve significant risks. As a result, BDC investments may not be suitable for all clients. Your Baird Financial Advisor can further explain the features, characteristics and risks of any particular security under consideration for your account.

Characteristics of BDCs

A BDC is defined by FINRA as a domestic, closed-end investment company that is operated for the purpose of making equity and debt investments in small and developing businesses, as well as financially troubled businesses. The BDC must make available significant managerial assistance to certain of its portfolio companies. A BDC is often characterized as a publicly traded venture capital or private equity firm that is registered with the SEC as an investment company and has elected to be treated as a business development company and subject to the provisions of Sections 55 through 65 of the Investment Company Act of 1940[1]. BDCs can be internally managed or managed by a separate investment advisory firm. Investment advisers or managers for BDCs often receive a management fee plus incentive or performance-based compensation. A BDC is subject to many of the same requirements as registered investment companies, including restrictions on their investments. BDCs are subject to rules regarding diversification (a limitation on how much they can own in a single company), industry concentration and transactions with affiliates. In addition, BDCs generally must invest at least 70% of their assets in designated assets, including securities of certain companies, cash, cash items, U.S. government securities, and high quality debt instruments. The companies in which a BDC can invest are primarily "eligible portfolio companies,"[2] which generally include small developing businesses and financially troubled businesses. BDCs are also limited in the amount of debt they can incur and securities more senior than common stock they can issue. This limitation is known as the 200% asset coverage test, which essentially means that the total amount of debt and senior securities that a BDC may have outstanding cannot exceed 50% of the value of the BDC's total assets. BDCs are treated as regulated investment companies for tax purposes and therefore not subject to corporate level tax so long as they distribute substantially all (e.g., 90%) of their net income and capital gains each year. Such income and gains are passed through to investors who are required to report such income and gains on their personal returns.

[1] See Section 2(a)(48) of the Investment Company Act of 1940

[2] See Section 2(a)(46) of the Investment Company Act of 1940

A debt security or preferred stock issued by a BDC can be rated by a nationally recognized rating agency, but in many cases the debt security or preferred stock is non-rated or is rated below investment grade, which can carry its own risks and rewards. BDC securities that are rated below investment grade are securities that are not rated in one of the four highest rating categories of a nationally recognized rating agency such as Moody's or S&P. Specifically, securities rated lower than Baa3 by Moody's or BBB- by S&P are below investment grade. Securities rated below Baa3 are described by Moody's as speculative and, at a minimum, subject to substantial credit risk. Securities rated below BBB- are described by S&P as having significant speculative characteristics and while their issuers may have some positive characteristics, they may be outweighed by large uncertainties or major exposures to adverse conditions. Non-rated BDC securities present additional uncertainty because of the difficulties in determining their comparability to rated securities. Non-rated securities are often comparable to below investment grade securities.

Baird's Equity Research department maintains research coverage on numerous BDCs. Please consult with your Baird Financial Advisor on whether Baird provides research reports on the BDCs in which you propose to invest and obtain copies of such reports. Baird's Investment Banking department may also serve as underwriter on public offerings of BDC securities. Your Baird Financial Advisor will receive a selling concession on the sale to you of BDC securities that Baird underwrites and thus have an incentive to offer them to you.

Understanding the risks

The risks associated with purchasing BDC securities are important considerations in making a purchase decision. Such risks include, but are not limited to portfolio company credit and investment risk, leverage risk, market and valuation risk, price volatility risk, liquidity risk, capital markets risk, interest rate risk, dependence on key personnel, and structural and regulatory risk.

- Portfolio company credit and investment risk. BDCs invest primarily in debt (senior, mezzanine and subordinated loans, both on a secured and unsecured basis) and equity securities of smaller and developing companies, as well as financially troubled companies, most of which are privately held and lack publicly available information. As a result, investments made by BDCs tend to be risky and speculative. The portfolio companies in which BDCs invest may have limited financial resources and may be unable to meet their obligations on the debt securities held by the BDCs, causing them to default. Portfolio companies may have shorter operating histories, narrower product lines and smaller market shares, rendering them potentially more vulnerable to competition, changing market conditions and economic downturns and causing them to have less predictable operating results. Portfolio companies may have difficulty accessing the capital markets to meet their future capital needs, limiting their ability to grow or repay their outstanding indebtedness when due. Portfolio companies may also be more dependent on their management teams and key personnel. BDCs thus are exposed to significant credit risk when they make loans to, or hold debt securities issued by, portfolio companies. Such loans or debt securities are generally non-rated but regarded as below investment grade. BDCs generally do not hold controlling interests in portfolio companies and are thus often not in a position to prevent decisions made by portfolio companies that could affect the value of the BDC's investments, such as decisions to incur additional debt that may be senior to or ranking equally to the debt securities or loans held by the BDCs or to issue additional equity securities that may dilute the

BDCs' equity interests. In addition, BDCs operate in a highly competitive market for investment opportunities, making it challenging to make investments in portfolio companies at attractive prices and on attractive terms.

- Leverage risk. Although BDCs are limited in the amount of indebtedness they may incur, BDCs commonly use leverage (i.e., borrow money) to make investments in portfolio companies through credit facilities and the issuance of debt or preferred securities. While leverage may enhance returns as the value of assets held by the BDCs increases, leverage may worsen or exacerbate the effect on a BDC's net asset value or stock price if the value of its assets deteriorates. In addition, because of the limitation on the amount of indebtedness that a BDC may incur, a decline in the value of a BDC's assets may prevent the BDC from incurring additional indebtedness to make investments or cause the BDC to sell assets at an inopportune time in order to lower its outstanding indebtedness.

- Market and valuation risk. Because investments made by BDCs are typically illiquid, such investments are challenging to value for purposes of determining a BDC's net asset value. Investments are marked to market on a quarterly basis and most are priced at fair value in good faith based on observable and unobservable inputs and assumptions pursuant to valuation procedures. It is possible that valuations on investments used are materially different from the values that BDCs ultimately receive upon disposition of those investments. The lack of liquidity of a BDC's investments makes it difficult to sell those investments if the need arises. Changing market and economic conditions affecting a BDC's investments may cause significant volatility in the BDC's net asset value and stock price. A BDC's net asset value includes unrealized appreciation and depreciation, as well as realized income, gains and losses.

- Price volatility and liquidity risk. The market price of securities issued by a BDC may fluctuate significantly. Such volatility may be affected by numerous factors, primarily due to the nature of a BDC's investments and the portfolio companies in which it invests but some of the volatility may be beyond the BDC's control. Such securities may trade at discounts from, or premiums to, their net asset value or par amounts. Also, there can be no assurance that the securities issued by a BDC will have an established trading market or otherwise have sufficient liquidity.

- Capital markets risk. The success of a BDC generally depends on its ability to raise capital to make investments at acceptable prices and on acceptable terms. Because BDCs are required to make annual distributions of substantially all of the net investment income and capital gains, BDCs need continual access to capital in order to make investments. At times, it may be difficult for a BDC to access the capital markets. A disruption in the credit markets or a tight credit market may prevent a BDC from securing a credit facility from one or more banks or to refinance an existing credit facility. If funds are not available, a BDC may not be able to make new investments, thus curbing its growth, and the BDC's net asset value could be negatively impacted. Regulatory restrictions may also affect the ability of a BDC to raise additional capital.

- Interest rate risk. Because BDCs borrow money to make investments, their net investment income largely depends on the difference between the rate at which they can borrow funds and the rate at which they can invest those funds. A significant change in prevailing interest rates can have a material adverse effect on a BDC's net investment income. In periods of rising interest rates, a BDC's cost of funds will increase and at the same time the BDC may not be able to increase the rate they receive on their investments.

- Dependence on key personnel. BDCs depend on investment professionals to identify structure and manage the BDC's investments in portfolio companies. If a BDC is unable to hire or retain qualified personnel or lose a member of its management or investment team, the BDC's performance can be adversely affected. The ability of a BDC to hire qualified personnel is also important in order to manage growth.

- Structural and regulatory risk. BDCs often have high fees and expenses that are deducted from their net assets for purposes of determining net asset values. This puts pressure on the BDCs to make investments that will generate sufficient returns in order to cover such fees and expenses. BDCs also often pay incentive compensation and fees to their investment professionals or advisors, which may give such professionals or advisors motivation to make riskier investments in order to earn their incentive compensation. BDCs are operated so as to qualify as a "regulated investment company" or "RIC" under the Internal Revenue code and while so qualified BDCs are not subject to corporate-level tax. However, in order to qualify as a RIC a BDC is required to make timely distributions of taxable income and gains to its shareholders. It is possible that a BDC may have difficulty satisfying this distribution requirement because in certain cases (such as recognition of original issue discount or receipt of non-cash, payment-in-kind interest) the BDC may recognize income before or without receiving cash representing such income. If a BDC fails to qualify as a RIC it will have to pay corporate-level taxes on its income whether or not the income is distributed, which would reduce the amount of income available for debt service or the amount of distributions the BDC can make. Also, because as a RIC a BDC needs to distribute substantially all of its income each year, the BDC will need to raise additional capital to finance its growth.

  BDCs are also regulated under the Investment Company Act, which imposes certain restrictions on BDCs. A BDC is limited in the amount of senior securities (debt and preferred stock) it may issue and indebtedness it may incur. Generally, a BDC may issue senior securities or incur indebtedness such that its asset coverage is equal to at least 200% after such issuance or incurrence (i.e., the value of its assets must be at least two times the value of its senior securities). If the value of a BDC's assets declines, the BDC may not be able to satisfy that test. A BDC is also restricted in its ability to issue common stock at a price below net asset value without shareholder and board approval. In addition, under the Investment Company Act, the holders of preferred stock of a BDC have the right to elect two directors and, if dividends on the preferred stock are in arrears by two years or more, a majority of the directors. Certain matters under the Investment Company Act require shareholder approval, although in many cases the board of directors of a BDC may modify or change operating policies and strategies without shareholder approval. Some BDCs may not be "diversified," meaning that they are not limited in the percentage of its assets that may be invested in a single portfolio company. Certain BDCs may have subsidiaries that are licensed to act as "small business investment companies," which are regulated by the US Small Business Administration (SBA). The SBA imposes limitations on the financing terms of investments by SBICs in portfolio companies. BDCs are subject to periodic examinations by the SEC and, for their SBIC subsidiaries (if any), the SBA and potentially regulatory fines, penalties and other sanctions for violations of applicable laws and rules.

Before investing in BDC securities, it is important to understand and discuss with your Baird Financial Advisor the structure and terms of the security and the potential risks. Investors in BDCs should have a high tolerance for risk, including the willingness and ability to accept significant price volatility, potential lack of liquidity and potential loss of their investment. If buying such investments in an offering, you should obtain and read the prospectus. If buying such securities in the secondary market, you should review the issuer's publicly available financial and other information (such as recent annual, quarterly and current reports). You can obtain these materials from your Baird Financial Advisor or on the SEC's EDGAR database at http://www.sec.gov.

For more information on the risks of non-rated, split-rated and below investment grade securities (including notes, debt securities and preferred stocks), please reference the disclosure – "Important Information About Non-Rated, Split-Rated or Below Investment Grade Securities and Securities in Lowest Investment Grade Category" located at https://bairdwealth.com/retailinvestor.

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