

CAPITAL SOUTHWEST CORP
Form 40-APP
January 30, 2017

File No. 812-13769

U.S. SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

APPLICATION FOR AN AMENDED ORDER PURSUANT TO SECTION 23(c)(3) OF THE INVESTMENT COMPANY ACT OF 1940, AS AMENDED, (THE "1940 ACT") GRANTING AN EXEMPTION FROM SECTION 23(c) OF THE 1940 ACT

CAPITAL SOUTHWEST CORPORATION

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January 30, 2017

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Exhibits:

EXHIBIT A	AMENDED AND RESTATED CAPITAL SOUTHWEST CORPORATION 2010 RESTRICTED STOCK AWARD PLAN
EXHIBIT B	RESOLUTION OF THE BOARD OF DIRECTORS OF CAPITAL SOUTHWEST CORPORATION – APPROVAL OF AMENDED AND RESTATED CAPITAL SOUTHWEST CORPORATION 2010

RESTRICTED STOCK AWARD PLAN

UNITED STATES OF AMERICA

Before the

SECURITIES AND EXCHANGE COMMISSION

In the Matter of

**CAPITAL SOUTHWEST
CORPORATION**

5400 Lyndon B Johnson
Freeway, Suite 1300

Dallas, Texas 75240

APPLICATION FOR AN AMENDED ORDER PURSUANT TO SECTION 23(c)(3) OF
THE INVESTMENT COMPANY ACT OF 1940, AS AMENDED, (THE "1940 ACT")
GRANTING AN EXEMPTION FROM SECTION 23(c) OF THE 1940 ACT

File No. 812-13769

Investment Company Act of
1940, as amended

I. INTRODUCTION

The undersigned applicant, Capital Southwest Corporation ("Capital Southwest" or the "Company"), an internally managed, non-diversified, closed-end investment company that has elected to be regulated as a business development company (a "BDC") under the Investment Company Act of 1940, as amended (the "1940 Act"), hereby applies for and requests an amendment to the prior order (the "Prior Order") of the U.S. Securities and Exchange Commission (the "Commission") pursuant to Section 6(c) of the 1940 Act that granted an exemption from Sections 23(a), 23(b) and 63 and pursuant to Sections 57(a)(4) and 57(i) of the 1940 Act and Rule 17d-1⁴ under the 1940 Act authorizing certain joint transactions otherwise prohibited by Section 57(a)(4) under the 1940 Act. The Prior Order permits Capital Southwest to issue restricted shares of its common stock under the terms of Capital Southwest Corporation 2010 Restricted Stock Award Plan (the "Plan") as part of the compensation packages for certain of its employees and certain

employees of its wholly-owned subsidiaries.

Capital Southwest seeks an amendment to the Prior Order (the "Amended Order") pursuant to Section 23(c)(3) of the 1940 Act to exempt Capital Southwest from Sections 23(c)(3) of the 1940 Act to allow it to withhold shares of the Company's common stock or purchase shares of the Company's common stock from the Participants (as defined in the Amended Plan) to satisfy tax withholding obligations relating to the vesting of Restricted Stock (as defined in the Amended Plan) or the exercise of options that were granted to them pursuant to the pursuant to the Plan or will be granted pursuant to the Amended and Restated Capital Southwest Corporation 2010 Restricted Stock Award Plan (the "Amended Plan").

¹ Section 2(a)(48) of the 1940 Act defines a business development company to be any closed-end investment company that operates for the purpose of making investments in securities described in Sections 55(a)(1) through 55(a)(3) of the 1940 Act and makes available significant managerial assistance with respect to the issuers of such securities.

² See Capital Southwest Corporation, Investment Company Act Release Nos. 29450 (notice) (September 29, 2010) and 29491 (order) (October 26, 2010).

³ Unless otherwise indicated, all section references herein are to the 1940 Act.

⁴ Unless otherwise indicated, all rule references herein are to rules promulgated under the 1940 Act.

⁵ The "Plan" and the "Amended Plan", together the "Plans".

II. CAPITAL SOUTHWEST CORPORATION

A. Background

Capital Southwest is a Texas corporation incorporated on April 19, 1961. Until September 1969, it operated as a small business investment company (“SBIC”) licensed under the Small Business Investment Act of 1958. At that time, Capital Southwest transferred to its wholly-owned subsidiary, Capital Southwest Venture Corporation (“CSVC”), certain assets and its license as a SBIC. CSVC was a closed-end, non-diversified investment company registered under the 1940 Act. Effective June 14, 2016, CSVC was dissolved and its SBIC license was surrendered. All assets held in CSVC were transferred to Capital Southwest upon dissolution. Prior to March 30, 1988, Capital Southwest was registered as a closed-end, non-diversified investment company under the 1940 Act. On that date, Capital Southwest elected to be treated as a BDC subject to the provisions of the 1940 Act, as amended by the Small Business Incentive Act of 1980. In order to remain a BDC, Capital Southwest must meet certain specified requirements under the 1940 Act, including investing at least 70% of its assets in eligible portfolio companies and limiting the amount of leverage it incurs.

Capital Southwest has elected to be treated as a regulated investment company (a “RIC”) under Subchapter M of the U.S. Internal Revenue Code of 1986, as amended, (the “Code”) and expects to continue to make such elections in the future. As a RIC, Capital Southwest is not required to pay corporate-level income tax on its investment income. Capital Southwest intends to maintain its RIC status, which requires that it qualifies annually as a RIC by meeting certain specified requirements.

On September 30, 2015, Capital Southwest completed the spin-off of CSW Industrials, Inc. (“CSWI”). CSWI is now an independent publicly traded company. CSWI’s common stock trades on the Nasdaq Global Select Market under the symbol “CSWI.” The spin-off was effected through a tax-free, pro-rata distribution of 100% of CSWI’s common stock to shareholders of the Company. Each Company shareholder received one share of CSWI common stock for every one share of Company common stock on the record date, September 18, 2015. Cash was paid in lieu of any fractional shares of CSWI common stock. Following the spin-off, the Company has maintained operations as an internally managed BDC and pursues a credit-focused investing strategy. The Company continues to provide capital to middle-market companies. The Company invests primarily in debt securities, including senior secured debt and subordinated debt, and may also invest in preferred stock and common stock alongside our debt investments or through warrants. Capital Southwest also invests in broadly syndicated first and second lien loans in large middle-market companies.

Capital Southwest Management Company (“CSMC”), a wholly-owned subsidiary of Capital Southwest, is the management company for Capital Southwest. CSMC generally incurs all normal operating and administrative expenses, including, but not limited to, salaries and related benefits, rent, office expenses and other administrative costs required for its day-to-day operations. Capital Southwest trades on the NASDAQ Global Select Market under

the symbol “CSWC.”

As of January 27, 2017, there were 15,966,025 shares of Capital Southwest’s common stock issued and outstanding. As of January 27, 2017, Capital Southwest and its wholly-owned consolidated subsidiaries had an aggregate of 17 employees.

Capital Southwest currently has a seven member board of directors (“Board”), of whom two are considered to be “interested persons” of Capital Southwest within the meaning of Section 2(a)(19) of the 1940 Act and five are not “interested persons” (the “Non-Interested Directors”). Capital Southwest has six directors who are not officers or employees of Capital Southwest.

B. The Business of Capital Southwest

Capital Southwest is an internally managed, non-diversified closed-end investment company that has elected to be treated as a BDC under the 1940 Act. Capital Southwest specializes in providing customized financing to middle-market companies in a broad range of investment segments located primarily in the United States. Capital Southwest’s principal investment objective is to produce attractive risk-adjusted returns by generating current income from its debt investments and capital appreciation from its equity and equity related investments. Capital Southwest’s investment strategy is to partner with business owners, management teams and financial sponsors to provide flexible financing solutions to fund growth, changes of control, or other corporate events. Capital Southwest invests primarily in senior and subordinated debt securities secured by interests in portfolio company assets, coupled with equity interests.

C. Capital Southwest's Incentive Compensation

1. The Plan

The Plan authorizes Capital Southwest to award restricted shares of its common stock to certain of its employees and certain employees of its wholly-owned consolidated subsidiaries under the Plan. A restricted stock award is an award of shares of the Company's common stock (which have full voting and dividend rights but are restricted with regard to sale or transfer), the restrictions on which lapse ratably over a specified period of time (generally five years). The Restricted Stock will be subject to restrictions on transferability and other restrictions as required by the Compensation Committee of the Board, which is comprised solely of Non-Interested Directors, (the "Compensation Committee") from time to time. Except to the extent restricted under the terms of the Plan, a Participant granted Restricted Stock will have all the rights of any other shareholder, including the right to vote the Restricted Stock and the right to receive dividends. During the restriction period (i.e., prior to the lapse of the applicable forfeiture restrictions), the Restricted Stock generally may not be sold, transferred, pledged, hypothecated, margined or otherwise encumbered by the Participant. Except as the Board otherwise determines, upon termination of a Participant's employment during the applicable restriction period, Restricted Stock for which forfeiture restrictions have not lapsed at the time of such termination shall be forfeited.

Pursuant to the Plan, the Board originally reserved 188,000 shares of restricted stock for issuance to certain of our employees. At our annual shareholder meeting in August 2015, the Company's shareholders approved an increase of an additional 450,000 shares to the Plan. A restricted stock award is an award of shares of the Company's common stock, which generally have full voting and dividend rights but are restricted with regard to sale or transfer. Restricted stock awards are independent of stock grants and are generally subject to forfeiture if employment terminates prior to these restrictions lapsing. Unless otherwise specified in the award agreement, these shares vest in equal annual installments over a four to five-year period from the grant date and are expensed over the vesting period starting on the grant date. Subject to adjustment as provided in Section 12 of the Plan, the Plan limits the total number of shares that may be awarded to any single Participant in a single year to 6,250. In addition, subject to adjustment as provided in Section 12 of the Plan, the maximum amount of Restricted Stock that may be issued under the Plan will be 10% of the outstanding shares of common stock of Capital Southwest on the effective date of the Plan plus 10% of the number shares of Capital Southwest's common stock issued or delivered by Capital Southwest (other than pursuant to compensation plans) during the term of the Plan.⁶ In addition, no Participant may be granted more than 25% of the shares of common stock reserved for issuance under the Plan, subject to adjustment as provided in Section 12 of the Plan.

On August 28, 2014, the Board amended the Plan, as permitted pursuant to Section 14 of the 2010 Plan (the "First Amendment to the Plan"). The First Amendment to the Plan provides that an award agreement may allow an award to remain outstanding after a spin-off or change in control of one or more wholly-owned subsidiaries of Capital Southwest. In addition, on August 28, 2014, the Board granted 127,000 shares of restricted stock under the Spin-Off Compensation Plan.

Each issuance of Restricted Stock under the Plan will be approved by the required majority, as defined in Section 57(o) of the 1940 Act,⁷ of Capital Southwest's directors on the basis that the issuance is in the best interests of Capital Southwest and its shareholders. The date on which the required majority, as defined in Section 57(o) of the 1940 Act, approves an issuance of Restricted Stock will be deemed the date on which the subject Restricted Stock is granted.

⁶ For purposes of calculating compliance with this limit, Capital Southwest counts as Restricted Stock all shares of its common stock that are issued pursuant to the Plan, less any shares that are forfeited back to Capital Southwest and cancelled as a result of forfeiture restrictions not lapsing.

⁷ The term "required majority," when used with respect to the approval of a proposed transaction, plan, or arrangement, means both a majority of a BDC's directors or general partners who have no financial interest in such transaction, plan, or arrangement and a majority of such directors or general partners who are not interested persons of such company.

Capital Southwest proposes to implement the Amended Plan, a copy of which is attached as Exhibit A hereto, upon receipt of the Amended Order. The Amended Plan explicitly permits Capital Southwest to withhold shares of the Company's common stock from the Participants to satisfy tax withholding obligations related to the vesting of Restricted Stock and the exercise of options to purchase shares of the Company's common stock granted pursuant to the Plan or Amended Plan. In this regard, the Amended Plan provides the following:

13. TAX WITHHOLDING

The Company's obligation to make cash payments pursuant to an Restricted Stock Award or deliver Shares, or any other event with respect to rights and benefits hereunder, shall be subject to the Participant's satisfaction of all applicable federal, state and local income and employment tax withholding obligations. To the extent that the Company is required to withhold any federal, state or local income and employment taxes in respect of any compensation income realized by the Participant in respect of Shares acquired pursuant to an Restricted Stock Award, or in respect of any Shares becoming vested, then the Company shall deduct from any payments of any kind otherwise due to such Participant the aggregate amount of such federal, state or local income and employment taxes required to be so withheld. If no such payments are due or become due to such Participant, or if such payments are insufficient to satisfy such federal, state or local income or employment taxes, then such Participant will be required to pay to the Company, or make other arrangements satisfactory to the Company regarding payment to the Company of, the aggregate amount of any such taxes. The Committee, in its discretion, may permit the Participant to satisfy the obligation, in whole or in part, by irrevocably electing to have the Company withhold Shares, or to deliver to the Company Shares that he or she already owns, having a value equal to the amount required to be withheld. The value of the Shares to be withheld, or delivered to the Company, shall be based on the Fair Market Value of Shares on the date the amount of tax to be withheld is determined. As an alternative, the Company may retain, or sell without notice, a number of such Shares sufficient to cover the amount required to be withheld.

The Amended Plan was approved by the Board as a whole, including a majority of the Non-Interested Directors and the required majority as defined in Section 57(o) of the 1940 Act, on January 25, 2017. If the Commission issues the Amended Order, the Amended Plan will become effective upon receipt of the Amended Order. After adoption of the Amended Plan, the Amended Plan will not be modified without obtaining an order of the Commission or the approval of the Commission. The Amended Plan provides that no grants may be made under the Amended Plan in contravention of the 1940 Act.

2. The Existing Stock Option Plans

Capital Southwest has two stock options plans, the 1999 Stock Option Plan and the Capital Southwest 2009 Stock Incentive Plan.

Capital Southwest previously granted stock options under its 1999 Stock Option Plan (the “1999 Plan”), as approved by shareholders on July 19, 1999. The 1999 Plan expired on April 19, 2009. Options previously granted under the 1999 Plan and outstanding on July 20, 2009 continue in effect and are governed by the provisions of the 1999 Plan. All options granted under the 1999 Plan were granted at market price on the date of grant, generally expire up to 10 years from the date of grant and are generally exercisable on or after the first anniversary of the date of grant in five to ten annual installments. At September 30, 2016, there were no options to acquire shares of common stock outstanding under the 1999 Plan.

Additionally, on July 20, 2009, Capital Southwest adopted the Capital Southwest 2009 Stock Incentive Plan (the “2009 Plan”) for the purpose of advancing the interest of Capital Southwest by providing for the grant of stock options to its employees. The 2009 Plan authorizes the issuance of up to 560,000 shares of Capital Southwest’s common stock (subject to adjustment for certain capital events such as stock splits, reverse stock splits, reorganizations, stock dividends, and similar transactions) upon the exercise of stock options. Awards may be made under the 2009 Plan to employees and officers of Capital Southwest.

On August 28, 2014, the Board amended the 2009 Plan, as permitted pursuant to Section 18 of the 2009 Plan (the “First Amendment to the 2009 Plan” and collectively with the 2009 Plan, the “Existing Stock Option Plans”). The First Amendment to the 2009 Plan provides that an award agreement may allow an award to remain outstanding after a spin-off or change in control of one or more wholly-owned subsidiaries of the Company. In addition, on August 28, 2014, options to purchase 259,000 shares at \$36.60 per share were granted under the 2009 Plan, as amended. On September 8, 2015, the Board designated the spin-off of CSWI a transformative transaction for purposes of the 2009 Plan and amended the award agreements granted under the 2009 Plan to provide for accelerated vesting of the awards held by a participant in the event of a termination of such participant’s service effected by the participant for good reason, by the employer without cause, or as a result of the disability or death of the participant. One-third of these options vested on December 29, 2015 and one-third vested on December 29, 2016, and the rest of the options will vest on December 29, 2017, subject to accelerated vesting as described above. Unless terminated sooner by the Board, the Existing Stock Option Plans will terminate on July 20, 2019, and no additional awards may be made after that date. As of January 27, 2017, options to purchase 251,635 shares of Capital Southwest’s common stock have been granted under the Existing Stock Option Plans.

Capital Southwest’s Existing Stock Option Plans enable Capital Southwest to provide to its officers and employees (1) incentive compensation commensurate with the creation of shareholder value; (2) opportunities for increased stock ownership by executives; and (3) competitive levels of total compensation over a long time horizon. Options are granted at the Nasdaq Stock Market’s closing price of Capital Southwest’s common stock on the date of grant and thus have no ultimate value unless the value of Capital Southwest’s common stock appreciates. Capital Southwest has never granted options with an exercise price that is less than the closing price of Capital Southwest’s common stock on the grant date, nor has it granted options which are priced on a date other than the grant date. Capital Southwest believes stock options provide a significant incentive for the option holders to enhance the value of Capital Southwest’s common stock by continually improving Capital Southwest’s performance and its investment results.

Options granted under the Existing Stock Option Plans generally vest in five annual installments beginning on the first anniversary of the date of grant and have a term of ten years. Under the 1999 Plan, upon termination of employment or retirement, option holders have 30 days to exercise vested options to purchase shares except in the case of death or disability (subject to a 6-month limitation). Under the 2009 Plan, upon termination of employment or retirement, incentive stock option holders have three months and non-statutory stock option holders have one month to exercise vested options to purchase shares except in the case of death or disability (subject to a 6-month limitation). Prior to the exercise of options, holders have no rights as shareholders with respect to the shares subject to such option, including voting rights and the right to receive dividends or dividend equivalents.

From time to time, the Compensation Committee has recommended and the Board has granted qualified and non-qualified stock options to executive officers and investment associates. Stock option award levels vary among participants based on their positions within Capital Southwest.

3. Employee Stock Ownership Plan

Capital Southwest maintains an Employee Stock Ownership Plan (“ESOP”) for employees as part of the ESOP of one of its wholly-owned portfolio companies in which its most highly compensated officers participate. Employees who have completed one year of credited service, as defined in the ESOP, are eligible to participate in the ESOP. Contributions to the ESOP are discretionary, within limits established by the Code. Funds contributed to the trust established under the ESOP are applied by the trustees to the purchase, in the open market at prevailing market prices, of Capital Southwest’s common stock. A participant’s interest in contributions to the ESOP fully vests after five years (three years effective April 1, 2008) of credited service, and such vested interest is distributed to a participant at retirement, death or total disability, or after a one year break in service resulting from termination of employment for any other reason. Thus, the ESOP rewards long-term employees, aligning their interests with those of Capital Southwest’s long-term shareholders.

4. Retirement Plans

Until the spin-off of CSWI, Capital Southwest sponsored a qualified defined benefit, non-contributory retirement plan (the "Retirement Plan") for its employees and employees of certain of its controlled affiliates. All officers of Capital Southwest participated in the Retirement Plan. The benefits under the Retirement Plan were based on years of service and an average of the highest five consecutive years of compensation during the last 10 years of employment. The Retirement Plan was closed to any employees hired or re-hired on or after January 1, 2015. In connection with the spin-off of CSWI, the Company entered into an Employee Matters Agreement with CSWI on September 8, 2015, which was amended and restated on September 14, 2015. Under the Employee Matters Agreement, Capital Southwest and CSMC withdrew as participating employers in the Retirement Plan and CSWI became the Sponsoring Employer of the Retirement Plan and assumed all the liabilities, assets, and future funding obligations for providing benefits for the covered participants under the Retirement Plan.

Capital Southwest also sponsored an unfunded Retirement Restoration Plan (the "Restoration Plan"), which was a nonqualified plan that provided for the payment, upon retirement, of the difference between the maximum annual payment permissible under the Retirement Plan pursuant to federal limitations and the amount which would otherwise have been payable under the Retirement Plan. Effective September 30, 2015, the benefits accrued under the Restoration Plan on behalf of CSWI employees, including employees who transferred from the Company to CSWI, were transferred to a non-qualified deferred compensation plan established by CSWI. The Company retained all liabilities associated with benefits accrued under the Restoration Plan on behalf of individuals who remain employees of the Company or CSMC following September 30, 2015 or who terminated employment prior to September 30, 2015 with vested benefits under the Restoration Plan. Unvested accrued benefits under the Restoration Plan were forfeited as of September 30, 2015.

5. Cash Bonus Program

Capital Southwest pays discretionary cash bonus awards to its employees annually. Capital Southwest's bonus program (the "Program") is not a profit-sharing plan for purposes of Section 57(a)(4) of the 1940 Act because the compensation paid to participating employees under the Program is not based on Capital Southwest's profitability. Thus, the amount a participant will receive each year under the Program will not be tied to Capital Southwest's gross or net income, or any other indicia of Capital Southwest's overall financial performance. Rather, awards under the Program are discretionary cash bonus awards based on the individual performance of the recipient. The total amount of awards made annually varies at the discretion of the Compensation Committee, depending on the extent and duration of Capital Southwest's growth, the participant's contribution to achieving overall Company growth over both long-term and short-term time horizons and the participant's creativity and effectiveness.

6. Phantom Stock Plan

On January 16, 2012, the Board approved the issuance of 104,000 phantom stock options at an exercise price of \$36.74 (Net Asset Value at December 31, 2011) pursuant to the Capital Southwest Corporation Phantom Stock Option Plan (the "Phantom Stock Plan") to provide deferred compensation to certain key employees. On January 22, 2013, the Board granted 16,200 shares of phantom stock options at an exercise price of \$41.34 per share (Net Asset Value at December 31, 2012) to officers of the Company. On July 15, 2013, the Board granted 24,000 shares of phantom stock options at an exercise price of \$43.80 per share (Net Asset Value at June 30, 2013) to a key officer of the Company. Additionally, the Board granted 38,000 shares of phantom stock options at an exercise price of \$50.25 per share (Net Asset Value at December 31, 2013) to several key employees of the Company in January 2014 and March 2014. Under the Phantom Stock Plan, awards vest on the fifth anniversary of the award date. Upon exercise of the phantom option, a cash payment in an amount for each phantom share equal to estimated fair market value minus the phantom option exercise price, adjusted for capital gain dividends declared, will be distributed to plan participants. There were no phantom stock options granted since March 2014.

III. TAX WITHHOLDING OBLIGATIONS AND PARTICIPANTS TO PAY THE EXERCISE PRICE OF OPTIONS WITH STOCK

A. Requested Order

Capital Southwest requests an order of the Commission for relief under Section 23(c) to permit Capital Southwest to withhold shares of its common stock or purchase shares of Capital Southwest's common stock from participants to satisfy tax withholding obligations related to the vesting of Restricted Stock or the exercise of options to purchase shares of Capital Southwest's common stock that were granted under the Plan or will be granted pursuant to the Plans. In addition, Capital Southwest requests an exemption from Section 23(c) to permit participants to pay the exercise price of options to purchase shares of Capital Southwest's common stock that were granted under the Plan or will be granted to them pursuant to the Plans with shares of Capital Southwest's common stock.

B. Tax Consequences of Restricted Stock Awards

Generally, a grant under the Plans will not result in taxable income to the recipient for U.S. federal income tax purposes at the time of the grant. Instead, the value of the Restricted Stock will generally be taxable to the recipient as ordinary income in the years in which the restrictions on the shares lapse. Such value will be the fair market value of the shares on the dates the restrictions lapse. Any recipient, however, may elect pursuant to Section 83(b) of the Code to treat the fair market value of the shares on the date of grant as ordinary income in the year of the grant, provided the recipient makes the election within 30 days after the date of the grant. Generally, participants forego such elections in order to avoid the risk of being taxed on compensation they never realize, either because they forfeit the Restricted Stock or the value of the Restricted Stock drops prior to vesting.

On the date the Restricted Stock vests (assuming no Section 83(b) election has been made), the shares are released to the Participant and available for sale or transfer (subject to Capital Southwest's share retention guidelines). In accordance with the applicable regulations of the Internal Revenue Service (the "IRS"), Capital Southwest requires the recipient to pay to it an amount sufficient to satisfy withholding taxes in respect of such compensation income at the time the restrictions on the shares lapse or the recipient makes a Section 83(b) election. Where the cumulative withholding for all employees exceeds \$100,000, the amounts withheld generally must be deposited with the IRS by the next business day; therefore, procedures generally must be implemented to collect the withholding from employees on the vesting date itself or as soon as possible thereafter.

In lieu of receiving a cash payment or withholding other compensation from a Participant, typically a stock plan will provide for withholding of shares equal in value at the vesting date to the monetary amount of the company's

withholding obligation, sometimes referred to as a “net share settlement.” In this scenario, shares with value equal to the tax payment are withheld from the award and may be returned to the plan reserve, if permitted under the terms of the plan or award agreement. If Capital Southwest withholds shares to satisfy this withholding tax obligation, instead of cash, the recipient nonetheless will be required to include in income the fair market value of the shares withheld.

The Amended Plan incorporates this concept of “net share settlement.” Specifically, it provides that Capital Southwest is authorized to withhold the Company’s common stock (in whole or in part) from any award of restricted shares granted in satisfaction of a participant’s tax obligations. However, no such withholding of shares will take place except pursuant to written assurance from the staff of the Commission or exemptive relief from the Commission.

C. Tax Consequences of Stock Option Awards

Options granted under the Plan will not be taxable to a recipient at the time of grant. Upon the exercise of an option, the amount by which the fair market value of the shares of Capital Southwest’s common stock received, determined as of the date of exercise, exceeds the exercise price will be treated as ordinary income to the recipient of the option in the year of exercise. In accordance with applicable regulations of the IRS, Capital Southwest requires the optionee to pay to it an amount sufficient to satisfy taxes required to be withheld in respect of such compensation income at the time of the exercise of the option. If Capital Southwest withholds shares to satisfy this withholding tax obligation, instead of cash, the optionee nonetheless will be required to include in income the fair market value of the shares withheld. When the optionee sells the shares of common stock received upon exercise of the option, he or she will generally recognize a capital gain or loss (long-term or short-term, depending upon the holding period of the stock sold) in an amount equal to the difference between the amount realized upon the sale of the shares and his or her basis in the shares (*i.e.*, the exercise price plus the amount taxed to the optionee as compensation income).

D. Applicable Law and Need for Relief

Section 23(c), which is made applicable to BDCs by Section 63, generally prohibits a BDC from purchasing any securities of which it is the issuer except in the open market pursuant to tenders, or “under such other circumstances as the Commission may permit by rules and regulations or orders for the protection of investors in order to insure that such purchases are made in a manner or on a basis which does not unfairly discriminate against any holders of the class or classes of securities to be purchased.” No rule addresses “purchases” by a BDC in the circumstances described in this Application. Thus, to the extent that the transactions between Capital Southwest and the Participants described in this Application with respect to the Plans constitute “purchases” by Capital Southwest of its own securities, Section 23(c) would prohibit these transactions.

E. Capital Southwest’s Legal Arguments

Section 23(c)(3) permits a BDC to purchase securities of which it is the issuer “under such . . . circumstances as the Commission may permit by . . . orders for the protection of investors in order to insure that such purchases are made in a manner or on a basis which does not unfairly discriminate against any holders of the class or classes of securities to be purchased.” As noted above, the transactions between Capital Southwest and the Participants described in this Application with respect to the Plans may entail “purchases” by Capital Southwest of its own securities within the meaning of Section 23(c). However, Capital Southwest submits that any such purchases will be made in a manner that does not unfairly discriminate against Capital Southwest’s other shareholders. In that regard, Capital Southwest currently uses the closing sales price of its shares of common stock on the Nasdaq Global Select Market (or any primary exchange on which its shares of common stock may be traded in the future) as the “fair market value” of its common stock under the Plans (*i.e.*, the date of grant of options). Capital Southwest will also use the closing sales price of its shares of common stock on the Nasdaq Global Select Market (or any primary exchange on which its shares of common stock may be traded in the future) as the “fair market value” of its common stock under the Plans (*i.e.*, the public market price on the date of grant of Restricted Stock and the date of grant of options). The shares of Capital Southwest’s common stock used to satisfy tax withholding will be valued based on the current fair market value on the date of the transaction. Because all of the transactions between Capital Southwest and the Participants described in this Application with respect to the Plans will take place at the public market price for Capital Southwest’s common stock, these transactions will not be significantly different than could be achieved by any shareholder selling in a transaction on the Nasdaq Global Select Market. Moreover, these transactions may be made only as permitted by the Plans, which will be approved by Capital Southwest’s shareholders prior to any application of the relief. These transactions permit Capital Southwest to deliver only shares net of the required tax withholding to the award recipients, thereby reducing the number of shares issued in connection with awards granted under the Plans. The resulting reduction in dilution using these transactions should benefit all of Capital Southwest’s shareholders. Finally, without the relief sought hereby, Capital Southwest’s executives and employees may be forced to sell more shares in the open market or a portion of the non-cash awards that vest or are delivered under the Plans to satisfy their tax withholding obligations. A large influx of Capital Southwest’s shares into the open market over a short period of time would not be beneficial to Capital Southwest’s shareholders. No transactions will be conducted pursuant to the Amended Order on days where there are no reported market transactions involving Capital Southwest’s shares. Moreover, the withholding provisions in the Plans do not raise concerns about preferential treatment of Capital

Southwest's insiders because the Plans are a bona fide compensation plan of the type that is common among corporations generally. Finally, the vesting schedule is determined at the time of the initial grant of the Restricted Stock and the option exercise price is determined at the time of the initial grant of the options.

In light of the foregoing, Capital Southwest believes that the requested relief meets the standards of Section 23(c)(3). Moreover, the important role that equity compensation can play in attracting and retaining qualified personnel has been expressly recognized by the Commission with respect to certain types of investment companies, including closed-end investment companies, SBICs and BDCs. Capital Southwest believes that its request for the Amended Order is consistent with the policies underlying the provisions of the 1940 Act permitting the use of equity compensation as well as prior exemptive relief granted by the Commission for relief under Section 23(c).

F. Precedent

The Commission has previously granted exemptive relief from Section 23(c) to BDCs in substantially similar circumstances. On January 10, 2017, the Commission issued an order for an exemption from Section 23(c) to permit Equus Total Return, Inc. to withhold shares of its common stock or purchase shares of its common stock from participants to satisfy tax withholding obligations relating to the vesting of restricted stock or the exercise of options that will be granted pursuant to its equity incentive plan.⁸ On May 10, 2016, the Commission issued an order for an exemption from Section 23(c) to permit Newtek Business Services Corp. to withhold shares of its common stock or purchase shares of its common stock from participants to satisfy tax withholding obligations relating to the vesting of restricted stock or the exercise of options to purchase shares of its common stock.⁹ On June 16, 2015, the Commission issued an order for an exemption from Section 23(c) to permit KCAP Financial, Inc. to withhold shares of its common stock or purchase shares of its common stock from participants to satisfy tax withholding obligations relating to the vesting of restricted stock or the exercise of options to purchase shares of its common stock.¹⁰ On April 3, 2012, the Commission issued an order for an exemption from Section 23(c) to permit Harris & Harris Group, Inc. to withhold shares of its common stock from participants and to permit participants to pay the exercise price of options that were granted to them pursuant to a predecessor plan with shares of common stock.¹¹ On June 22, 2010, the Commission issued an amended order for an exemption from Section 23(c) permitting Hercules Capital, Inc. to withhold shares of its common stock or purchase shares of its common stock from the participants to satisfy tax withholding obligations related to the vesting of restricted stock that were or will be granted pursuant to its incentive compensation plans.¹² On April 20, 2010, the Commission issued an order for an exemption from Section 23(c) permitting MCG Capital Corporation to withhold shares of its common stock or purchase shares of its common stock from the participants to satisfy tax withholding obligations related to the vesting of restricted stock that were or will be granted pursuant to its incentive compensation plans.¹³ On June 16, 2009, the Commission issued an amended order granting Main Street Capital Corporation et al. exemptive relief from Section 23(c) to permit it, pursuant to its Plan, to engage in certain transactions that may constitute purchases by Main Street Capital Corporation of its own securities within the meaning of Section 23(c).¹⁴ On May 5, 2009, the Commission issued an amended order granting Triangle Capital Corporation exemptive relief from Section 23(c) in connection with withholding obligations related to vesting Restricted Stock and option exercises, and the payment of an option exercise price with shares of common stock already held by the participant.¹⁵

Additionally, in 1998, the Commission issued Baker, Fentress & Company and Adams Express Company, et al. exemptive relief from Section 23(c) in connection with the payment of a stock option exercise price with previously acquired stock.

Because the exemptive relief sought by this Application is substantially identical to those in a number of orders granted by the Commission permitting comparable arrangements, including the orders issued to Equus Total Return, Inc., Newtek Business Services Corp., KCAP Financial, Inc., Harris & Harris Group, Inc., Hercules Capital, Inc., MCG Capital Corporation, Main Street Capital Corporation et al., and Triangle Capital Corporation discussed above, Capital Southwest respectfully requests that the Commission grant the exemptive relief requested by this Application.

In addition, it is important to highlight that that stock withholding provisions and the other provisions contained in the Plans described in this Application are common features found in the equity compensation pl