April 14, 2017

The Honorable Michael Crapo, Chairman
The Honrable Sherrod Brown, Ranking Member
Senate Committee on Banking, Housing, & Urban Affiars
United States Senate
Room 534 Senate Dirksen Office Building
Washington, DC 20510

Dear Chairman Crapo and Ranking Member Brown:

Prospect Capital appreciates the Banking Committee's request for proposals to promote economic growth and to enable consumers and market participants help consumers, market participants, and financial companies responsibly participate in the economy in a more effective and efficient manner. We believe that the Committee should consider legislation to modernize the securities laws governing business development companies (BDCs) to help expand capital availability to small- and medium-sized companies.

Prospect Capital is a business development company, a closed-end investment company that focuses on investing in small- and medium-sized private companies rather than large public companies. Our company completed its initial public offering in July 2004, and since then we have invested more than $10 billion in over 200 small- and medium-sized companies. Prospect is a growing company whose operations utilize almost 100 employees in 4 locations – New York, Houston, San Francisco and Darien, Connecticut.

Prospect invests primarily in first-lien and second-lien senior loans and mezzanine debt, which in some cases include an equity component. Our flexible mandate allows Prospect to provide capital to small- and medium-sized companies for re-financings, leveraged buyouts, acquisitions, recapitalizations, later-stage growth investments, and capital expenditures.

Small- and medium-sized companies use capital from Prospect to expand their businesses, hire workers, construct factories, and achieve other important objectives. Prospect's portfolio is diversified across a wide variety of industries – about 50 in total – including manufacturing, industrials, energy, business services, financial services, food, healthcare, and media. The small- and medium-sized companies we finance employ more than 100,000 American workers in nearly every state in the nation.

We are proud of our track record supporting scores of small- and medium-sized companies that we have helped grow over time. In the last calendar year we have already closed more than $1.1 billion of investments, and we closed about $470 million of originations in the

last quarter thereof. Our capital has helped create thousands of American jobs over the years, and our capital is much needed in this critical period of high unemployment and economic uncertainty.

Business Development Companies

In 1980, Congress enacted amendments to the Investment Company Act of 1940 authorizing business development companies (BDCs). Congress wanted to facilitate private finance investment at a time when, much like today, bank balance sheets were reeling from a period of economic largesse in the 1970s, and small- and medium-sized American businesses faced limited credit options. In response, Congress authorized a publicly traded, closed-end fund structure, the sole intent of which was to facilitate private finance investment to small- and medium-sized American businesses while offering such homegrown businesses significant guidance and counseling concerning management, operations, business objectives, and policies. Put simply, a BDC is a lender to and investor in small- and medium-sized businesses and has stepped into a role commercial banks have largely abandoned – lending to small- and medium-sized American businesses that might not otherwise obtain financing to grow.

BDCs must invest at least 70% of their assets in so-called "eligible assets." The most common types of "eligible assets" are private and "micro-cap" public American companies (those with less than $250 million in market capitalization). These investments must be privately negotiated and the BDC is required to offer managerial assistance to these companies in which the BDC invests to meet specific business challenges.

Financing these companies requires significant time and energy by the lender or capital provider, including due diligence activities and rigorous credit analysis that have become uneconomical for traditional banks, with transaction sizes that are too small for many other capital providers.

Thus, for small- and medium-sized companies BDCs represent a very important source of capital. Our industry today is composed of about 50 publicly traded BDCs collectively managing $63.8 billion in assets (up from $11.6 billion in 2004) with an aggregate market capitalization of $34.55 billion. BDCs have become an integral part of the credit markets.

BDCs are heavily regulated. They are public companies that are subject to the Securities Act of 1933 and file an election with the SEC to also become subject to the Investment Company Act of 1940. Thus, BDCs are transparent vehicles both for investors and for small- and medium-sized American companies seeking capital.

The shareholders of BDCs, many of them retirees on a fixed income, receive the investor protections of our securities laws while having an opportunity to participate in the types of investments that otherwise are only available to deep-pocket investors through private partnerships. BDCs also offer advantages to the companies that are in need of investment capital to grow. For many of the companies in which a BDC invests, traditional sources of financing like bank lending or public offerings are unavailable. For these companies, BDCs offer an alternative source of capital that is subject to public disclosure and transparency.

In summary, BDCs provide substantial benefits to the American economy, including the opportunity for the investing public to invest in smaller growing businesses and the opportunity for such small- and medium-sized companies to obtain much-needed financing.

I. BRIEF DESCRIPTION OF PROPOSAL

We suggest that the Committee amend the Investment Company Act of 1940 by adopting some of the provisions reported by the bipartisan vote of 53 to 4 by the House Financial Services Committee in the last Congress (H.R. 3868). A few modest reforms to our securities laws that were included in that legislation can help every BDC more effectively achieve their purpose without undermining investor protections. We understand that BDCs that had urged adoption of reforms not identified below are no longer urging their adoption.

(1) Further Update the Definition of Eligible Portfolio Company to Allow Small Financial Companies to Participate in Economic Growth Opportunity.

Registered investment companies are allowed to invest in financial services companies, including community banks, leasing companies, factoring firms, and automobile financing companies. However, as described above, BDCs must invest at least 70% of their assets in "eligible portfolio companies." When Congress created BDCs, it focused on industry and services, but excluded financial services companies from qualifying as "eligible portfolio companies." Thus, no more than 30% of a BDC's assets can be invested in financial companies. This limitation makes no sense decades later given the substantial growth of financial services as a leading job provider in the American economy since 1980. Financial services companies employ millions of American workers and have a capital magnifying effect that results in more capital flowing into small- and medium-sized American businesses.

A policy that limits BDC investments in small- and medium-sized financial services companies runs counter to the objective of helping attract capital for the benefit of small- and medium-sized American companies. In fact, frequently such companies in turn serve the financial services needs of other, smaller companies. BDCs should not have limits on providing capital to such important companies. Financial service companies serve a vital role in our economy and should be encouraged, not stifled.

Financial businesses that are subject to the current law limitation are comprised of a wide array of companies: community banks, insurance and reinsurance businesses, asset and investment advisors, real estate businesses, industrial loan companies, consumer financing businesses, credit card receivables companies, business inventory and receivables financing companies, automobile financing businesses, equipment financing businesses, companies making loans to purchase livestock feed and farm products, companies owning or holding oil, gas or mineral leases or royalty interests, and many more. Again, these types of companies amplify the amount of capital made available to small- and medium-sized

American businesses and American consumers, thereby helping with economic stimulation and job creation at no cost to the federal government.

Proposed change:
Under the proposal financial service companies described in section 3(c)(2), (3), (4), (5), (6) or (9) of the Investment Company Act of 1940 would become eligible portfolio companies. However, we propose that entities described in section 3(c)(1) and (7) of the Investment Company Act of 1940 (e.g., private equity, hedge funds, collateralized debt obligations, etc.) that can only be sold to qualified investors would remain excluded from the definition of eligible portfolio company. In addition, the proposal would cap the total amount of investments in any entity described in section 3(c) of the Investment Company Act of 1940 to 50% of BDC total assets. We believe that such a cap would still make the reform meaningful and would further the objectives I have described above.

(2) Allow BDCs to Raise Capital More Efficiently

Reducing the cost of raising capital benefits both BDC shareholders and the small- and medium-sized American companies in which they invest. These changes are also contained in the discussion draft.

(A) Shelf Registration Forms

BDCs, like other companies that regularly raise capital through securities issuances, rely on pre-filed "shelf registration" – a securities filing that allows a company to be prepositioned to issue additional securities. Because shelf registrations contain financial information that becomes outdated as companies publicly report their most recent financial information, companies are allowed to incorporate by reference in their shelf registrations subsequent financial reports. However, BDCs are not allowed to take advantage of this common sense approach, and instead we must manually update our shelf registration statements *each time* we report new quarterly information. This slows down the timetable for a BDC to access the capital markets and adds the unnecessary expense of lawyers, accountants and printers to the securities offering process.

Proposed Change:
The proposal would require the SEC to reform the forms and instructions for shelf registrations to treat BDCs like other companies eligible to use shelf registration statements. BDCs currently must copy and paste entire documents over and over again into filings, thereby requiring armies of lawyers, accountants, and printers. Every other type of public company in America has more streamlined rules reflecting the electronic age. BDCs should have access to the same streamlined filing benefits.

(B) Offering Reform

BDCs can only offer additional capital to small- and medium-sized American companies when we can increase our own capital. Our industry is traditionally a frequent issuer of

new securities offerings to raise such funds. For example, Prospect has raised over $3.5 billion since our IPO in 2004 through equity offerings.

In 2005 the SEC modernized the issuance process for frequent issuers, reducing costs and making the process more efficient. However, BDCs were excluded from these common sense reforms, with a promise that the issue would be revisited. A decade later nothing has happened. This situation has not benefited the capital needs of small- and medium-sized companies, nor has it provided any beneficial investor protections. It is time that our business development companies have the same access to the capital markets as enjoyed by other publicly traded companies.

Proposed Change:
The proposal would remove the restriction on BDC eligibility to rely on the offering reform regulations. There is no public policy justification for BDCs being left behind when the SEC modernized the rules that govern how companies can raise capital in the public markets.

(C) Leverage Limitation

The Investment Company Act of 1940 imposes very conservative leverage limitations on BDCs. The leverage limitations have not been revisited for the past 35 years since Congress initially adopted them as part of the original BDC enabling legislation. It is important that the leverage limitation be modernized to allow for BDCs to construct the appropriate balance sheet that is in the best interest of their shareholders. It is possible to increase the amount of debt a BDC can assume to allow BDCs to better balance the percentage of equity and debt while remaining conservative. Today a BDC can borrow up to $3 for every $6 they hold in assets -- a 200% ratio of assets to debt.

Proposed Change:
The proposal would allow a BDC to borrow up to a maximum of $4 for every $6 they hold in assets – a 150% ratio of assets to debt. The proposal would require a majority of the independent directors to authorize a BDC to use the 150% ratio and delay the effective date of such a change for one year to allow unless a majority of the shareholders vote to adopt such change.

IMPACT ON ECONOMIC GROWTH

We believe that modest changes to our securities laws can greatly enhance the benefit offered by BDCs to the American economy and allow BDCs to better serve the capital needs of small- and medium-sized companies. Our industry already helps to create many American jobs, and if Congress modernizes some of the rules under which BDCs operate we believe that our industry will be able to create many, many more.

IMPACT ON THE ABILITY OF FINANICAL COMPANIES AND OTHERS TO PARTICIPATE MORE EFFECTIVELY

Current law overly restricts small and middle-sized financial service company access to capital that BDCs can offer. Increasing that limitation from 30% to 50% will greatly benefit

these smaller financial service companies without changing the fundamental characteristics of BDCs. Similarly, the other recommendations made above will help BDCs operate more efficiently.

LEGISLATIVE LANGUAGE

Attached is legislative language to accomplish the changes suggested above.

Conclusion

In conclusion, business development companies are an important source of capital for small- and medium-sized businesses. With some common sense reforms it is possible to increase the capacity of BDCs to offer capital to job-creating American businesses without in any way undermining the strong investor protections afforded by the Investment Company Act of 1940.

Sincerely,

Joseph Ferraro
General Counsel
Prospect Capital

SEC. __. **BUSINESS DEVELOPMENT COMPANY OWNERSHIP OF SECURITIES OF CERTAIN FINANCIAL COMPANIES.**

Section 55 of the Investment Company Act of 1940 (15 U.S.C. 80a-54) is amended by adding at the end the following:

``(c) Securities Deemed To Be Permissible Assets.--Notwithstanding subsection (a), securities that would be described in paragraphs (1) through (6) of such subsection except that the issuer is a company section 3(c) may be deemed to be assets described in paragraphs (1) through (6) of subsection (a) to the extent necessary for the sum of the assets to equal 70 percent of the value of a business development company's total assets (other than assets described in paragraph (7) of subsection (a)), provided that the aggregate value of such securities counting toward such 70 percent shall not exceed 20 percent of the value of the business development company's total assets.''.

SEC. __. **EXPANDING ACCESS TO CAPITAL FOR BUSINESS DEVELOPMENT COMPANIES.**

(a) In General.--Section 61(a) of the Investment Company Act of 1940 (15 U.S.C. 80a-60(a)) is amended--

(1) by redesignating paragraphs (2) through (4) as paragraphs (3) through (5), respectively;

(2) by striking paragraph (1) and inserting the following:

``(1) Except as provided in paragraph (2), the asset coverage requirements of subparagraphs (A) and (B) of section 18(a)(1) (and any related rule promulgated under this Act) applicable to business development companies shall be 200 percent.

``(2) The asset coverage requirements of subparagraphs (A) and (B) of section 18(a)(1) and of subparagraphs (A) and (B) of section 18(a)(2) (and any related rule promulgated under this Act) applicable to a business development company shall be 150 percent if--

``(A) within five business days of the approval of the adoption of the asset coverage requirements described in clause (ii), the business development company discloses such approval and the date of its effectiveness in a Form 8-K filed with the Commission and in a notice on its website and discloses in its periodic filings made under section 13 of the Securities Exchange Act of 1934 (15 U.S.C. 78m)--

``(i) the aggregate value of the senior

securities issued by such company and the asset coverage percentage as of the date of such company's most recent financial statements; and

``(ii) that such company has adopted the asset coverage requirements of this subparagraph and the effective date of such requirements;

``(B) with respect to a business development company that issues equity securities that are registered on a national securities exchange, the periodic filings of the company under section 13(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78m) include disclosures reasonably designed to ensure that shareholders are informed of--

``(i) the amount of indebtedness and asset coverage ratio of the company, determined as of the date of the financial statements of the company dated on or most recently before the date of such filing; and

``(ii) the principal risk factors associated with such indebtedness, to the extent such risk is incurred by the company; and

``(C)(i) the application of this paragraph to the company is approved by the required majority (as defined in section 57(o)) of the directors of or general partners of such company who are not interested persons of the business development company, which application shall become effective on the date that is 1 year after the date of the approval, and, with respect to a business development company that issues equity securities that are not registered on a national securities exchange, the company extends, to each person who is a shareholder as of the date of the approval, an offer to repurchase the equity securities held by such person as of such approval date, with 25 percent of such securities to be repurchased in each of the four quarters following such approval date; or

``(ii) the company obtains, at a special or annual meeting of shareholders or partners at which a quorum is present, the approval of more than 50 percent of votes cast of the application of this paragraph to the company, which application shall become effective on the date immediately after the date of the approval.”

SEC. __. **PARITY FOR BUSINESS DEVELOPMENT COMPANIES REGARDING OFFERING AND PROXY RULES.**

(a) Revision to Rules.--Not later than 1 year after the date of enactment of this Act, the Securities and Exchange Commission

shall revise any rules to the extent necessary to allow a business development company that has filed an election pursuant to section 54 of the Investment Company Act of 1940 (15 U.S.C. 80a-53) to use the securities offering and proxy rules that are available to other issuers that are required to file reports under section 13 or section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m; 78o(d)). Any action that the Commission takes pursuant to this subsection shall include the following:

(1) The Commission shall revise rule 405 under the Securities Act of 1933 (17 C.F.R. 230.405)--

(A) to remove the exclusion of a business development company from the definition of a well-known seasoned issuer provided by that rule; and

(B) to add registration statements filed on Form N-2 to the definition of automatic shelf registration statement provided by that rule.

(2) The Commission shall revise rules 168 and 169 under the Securities Act of 1933 (17 C.F.R. 230.168 and 230.169) to remove the exclusion of a business development company from an issuer that can use the exemptions provided by those rules.

(3) The Commission shall revise rules 163 and 163A under the Securities Act of 1933 (17 C.F.R. 230.163 and 230.163A) to remove a business development company from the list of issuers that are ineligible to use the exemptions provided by those rules.

(4) The Commission shall revise rule 134 under the Securities Act of 1933 (17 C.F.R. 230.134) to remove the exclusion of a business development company from that rule.

(5) The Commission shall revise rules 138 and 139 under the Securities Act of 1933 (17 C.F.R. 230.138 and 230.139) to specifically include a business development company as an issuer to which those rules apply.

(6) The Commission shall revise rule 164 under the Securities Act of 1933 (17 C.F.R. 230.164) to remove a business development company from the list of issuers that are excluded from that rule.

(7) The Commission shall revise rule 433 under the Securities Act of 1933 (17 C.F.R. 230.433) to specifically include a business development company that is a well-known seasoned issuer as an issuer to which that rule applies.

(8) The Commission shall revise rule 415 under the Securities Act of 1933 (17 C.F.R. 230.415)--

(A) to state that the registration for securities provided by that rule includes securities registered by a business development company on Form N-2; and

(B) to provide an exception for a business development company from the requirement that a

Form N-2 registrant must furnish the undertakings required by item 34.4 of Form N-2.

(9) The Commission shall revise rule 497 under the Securities Act of 1933 (17 C.F.R. 230.497) to include a process for a business development company to file a form of prospectus that is parallel to the process for filing a form of prospectus under rule 424(b).

(10) The Commission shall revise rules 172 and 173 under the Securities Act of 1933 (17 C.F.R. 230.172 and 230.173) to remove the exclusion of an offering of a business development company from those rules.

(11) The Commission shall revise rule 418 under the Securities Act of 1933 (17 C.F.R. 230.418) to provide that a business development company that would otherwise meet the eligibility requirements of General Instruction I.A of Form S-3 shall be exempt from paragraph (a)(3) of that rule.

(12) The Commission shall revise rule 14a-101 under the Securities Exchange Act of 1934 (17 C.F.R. 240.14a-101) to provide that a business development company that would otherwise meet the requirements of General Instruction I.A of Form S-3 shall be deemed to meet the requirements of Form S-3 for purposes of Schedule 14A.

(13) The Commission shall revise rule 103 under Regulation FD (17 C.F.R. 243.103) to provide that paragraph (a) of that rule applies for purposes of Form N-2.

(b) Revision to Form N-2.--Not later than 1 year after the date of enactment of this Act, the Commission shall revise Form N-2--

(1) to include an item or instruction that is similar to item 12 on Form S-3 to provide that a business development company that would otherwise meet the requirements of Form S-3 shall incorporate by reference its reports and documents filed under the Securities Exchange Act of 1934 into its registration statement filed on Form N-2; and

(2) to include an item or instruction that is similar to the instruction regarding automatic shelf offerings by well-known seasoned issuers on Form S-3 to provide that a business development company that is a well-known seasoned issuer may file automatic shelf offerings on Form N-2.

(c) Treatment if Revisions Not Completed in Timely Manner.--If the Commission fails to complete the revisions required by subsections (a) and (b) by the time required by such subsections, a business development company shall be entitled to treat such revisions as having been completed in accordance with the actions required to be taken by the Commission by such subsections until such time as such revisions are completed by the Commission.

(d) Rule of Construction.--Any reference in this section to a rule or form means such rule or form or any successor rule or

form.