April 14, 2017

The Honorable Mike Crapo
Chairman
Committee on Banking, Housing,
and Urban Affairs
United States Senate
Washington, DC 20510

The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing,
and Urban Affairs
United States Senate
Washington, DC 20510

Dear Chairman Crapo and Ranking Member Brown:

Thank you for seeking public input for solutions to increase economic growth. While there are titanic debates at the global level about how to increase macro-economies, there needs to be a greater discussion and real-world improvement on the small and medium-sized businesses that drive the economy and are too often an afterthought. The American middle market represents just 3% of all companies, but it accounts for a third of U.S. private sector gross domestic product (GDP) and jobs.[1] Empowering this segment of the market will have real, beneficial impacts. To promote economic growth, the focus should be on small and medium-sized businesses.

The Small Business Investor Alliance (SBIA), the trade association representing small business investors since 1958, proposes legislation to improve the ability of Business Development Companies (BDCs) to operate efficiently and to increase the amount of capital available for investment into domestic small and medium-sized businesses. We propose a new, narrowly focused version of the "Small Business Credit Availability Act" with just two components: (1) to permit BDCs to modestly increase leverage and (2) to streamline the offering process for BDCs.

Background on the BDC Industry

Our association was the leading champion for Congress to create BDCs in 1980 to increase capital flowing primarily to private, U.S. businesses, including those seeking to grow and create jobs, but which often face obstacles in obtaining capital through traditional financing sources. BDCs were also created to provide retail investors access to the private equity and venture capital markets that are otherwise largely out of reach for normal Americans. Overall, they are a hybrid of an investment fund and an operating company, are highly regulated by the Securities and Exchange Commission (SEC), accordingly provide a very high level of transparency to their investors, and have experienced robust industry growth in recent years in the wake of the financial crisis. Importantly, BDCs are required to invest at least 70% of their

[1] "4Q 2016 Middle Market Indicator." National Center for the Middle Market. http://www.middlemarketcenter.org/Media/Documents/MiddleMarketIndicators/2016-Q4/FullReport/NCMM_MMI_Q4_2016_web.pdf.

assets in American small and medium-sized businesses. Middle market businesses, like those invested in by BDCs, account for three out of five net new private sector jobs and are outpacing other sectors of the economy in revenue growth.[2]

10 years ago, the BDC industry represented $25 billion and has more than tripled to $87 billion today. BDCs typically make secured and unsecured loans between $10 and $50 million and are an important part of the small and medium-sized access to capital solution. With unnecessary regulatory friction removed, BDCs can be an even bigger source of capital to a far greater number of small and medium-sized businesses that are regularly overlooked by policies made in Washington.

While there are many additional reforms the BDC industry continues to advocate for, there are two very simple, very straightforward reforms that enjoy unified industry support and should garner broad bipartisan support. First, BDCs should be given the option, not the mandate, to access a modestly higher borrowing capacity. Second, the securities offering reforms adopted by the SEC in 2005 for operating companies should be applied to BDCs given that they raise capital in a manner more akin to operating companies than investment funds. These are the two core provisions of H.R. 3868 that received overwhelming bipartisan support via a 53-4 vote in the House Financial Services Committee last Congress.

BDC Borrowing Limit Increase

In May 2016, testimony on behalf of the SBIA to this committee supporting the "Small Business Credit Availability Act" detailed the requirement of BDCs to maintain a 1:1 debt-to-equity ratio and why this ratio tightly limits the leverage BDCs can deploy to invest in small and medium-sized U.S. businesses. [3] Unlike banks, BDCs do not have depositors, FDIC insurance, and have never been considered to pose systemic risk. Banks regularly have leverage ratios in excess of 10:1, whereas BDCs are only asking for the option to have a ceiling at 2:1.

Section 2 of this proposed "Small Business Credit Availability Act" would allow BDCs, via board vote or shareholder vote, to modestly increase their debt/equity ratio to 2:1. The process for reaching that ratio would be optional, not be immediate, and would continue to ensure robust protections for investors in BDCs. In this regard, significant investor protections were added to this bill for those BDCs seeking to avail themselves to the higher leverage limit.

SEC Offering Reform for BDCs

In 2005, the SEC enacted reforms to streamline and improve the securities offering process for operating companies. As has been too often the case being a relatively small part of the market, BDCs and the small and medium-sized businesses they serve were overlooked in these reforms. Omitting BDCs from these reforms wastes inordinate amounts of SEC resources and adds unnecessary costs and delays to BDCs operators. Maintaining the cumbersome

---

[2] "4Q 2016 Middle Market Indicator." National Center for the Middle Market.

[3] Hearing on "Improving Communities and Business Access to Capital and Economic Development." https://www.banking.senate.gov/public/_cache/files/1c2aa559-e01c-4715-a316-516e4fd9cf6f/B6A4BEB55E55B69732C01095CCB03CF6.051916-arougheti-testimony-sii.pdf.

regulatory status quo provides no benefit to regulators, BDCs, investors, or companies seeking access to capital. The BDC regulatory offering structure is in dire need of modernization.

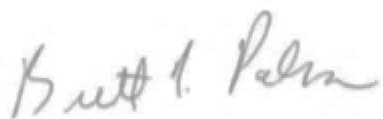
Section 3 of this proposed legislation would provide parity to BDCs on securities offering and other related rules enacted by the SEC for operating companies. Specifically, it would direct the SEC to revise rules to allow BDCs to incorporate by reference, thereby providing more efficient disclosures by pointing to previous filings, and for BDCs to qualify for "well-known seasoned issuer" status, a rigorous classification that would grant these companies greater flexibility in the process of offering their securities and communicating with investors. These reforms would allow BDCs to raise capital in the same efficient manner as operating companies and thus permit them to invest more of their dollars in U.S. businesses as opposed to complying with outdated securities offering rules.

Both the SBIA's previous testimony last year before this committee and earlier before the House Financial Services Capital Markets and Government Sponsored Enterprises Subcommittee, in June 2015, [4] supported these SEC reforms, as well as the debt/equity ratio increase. These reforms were ultimately approved by the House committee in a much larger legislative package on a 53-4 vote, as noted. In addition, this committee held a hearing on these issues last year. It is important to reiterate that the SBIA's proposal removes a host of provisions that were still sources of debate. Instead, the SBIA's proposal is limited to the two core proposals that have garnered the greatest consensus.

The congressional mandate for BDCs to provide capital to small and medium-sized businesses and the statistics illustrating the middle market's importance to the American economy underscore this proposal's potential impact on economic growth and increasing participation in the economy. This year, U.S. middle market businesses are expecting revenue growth at a rate of 5.5% and employment to increase at a rate of 3.4%.[5] However, these simple reforms proposed in this version of the "Small Business Credit Availability Act" provides the potential to enhance that growth and job creation.

The SBIA thanks you for attention to this proposal and looks forward to working with the members of this committee and Congress to promote economic growth by supporting investment in small and medium-sized businesses.

Sincerely,



Brett Palmer
President
Small Business Investor Alliance

---

[4] Hearing on "Legislative Proposals to Modernize Business Development Companies and Expand Investment Opportunities." http://financialservices.house.gov/uploadedfiles/hhrg-114-ba16-wstate-vfoster-20150616.pdf.
[5] "4Q 2016 Middle Market Indicator." National Center for the Middle Market."

Sample Draft: BDC Modernization Act ("Skinny Bill")

A BILL

To amend the Investment Company Act of 1940 to moderately increase the asset coverage ratio of business development companies inclusive with additional investor protections and to direct the Securities and Exchange Commission to revise certain offering rules relating to business development companies, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

***SECTION 1.* Short title.**

This Act may be cited as the *"Small Business Credit Availability Act"*.

***SECTION 2.* 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 the 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."

SECTION 3. 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.