SMALL BUSINESS INVESTOR ALLIANCE

Business Development Companies and the Acquired Funds and Expense Fees Rule

Background: What is a BDC? A BDC is a SEC registered investment fund that pools capital to invest in domestic small and midsize businesses. Portfolio companies are typically early-stage with good growth potential or distressed businesses that BDC managers can turn around.

What is the benefit of BDCs? BDCs invest in private small businesses that are not ready to be publicly traded themselves but need access to capital. But they are employing the BDC benefit is two-fold – it fills that access to capital gap for 1000's of smaller businesses and unlocks attractive investment opportunities for ordinary folks. In other words, you do not have to be extremely wealthy or an investment professional to get the benefit of investing in the long-term growth of small private companies – just buy BDC stock.

Business Development Companies Overview

- Congress created Business Development Companies (BDCs) in 1980 to facilitate capital formation and managerial assistance to small- and medium-sized businesses.
- There are currently 139 BDCs in existence in the U.S. with $310 billion in assets. BDCs have various investment strategies that run the gamut from debt to equity.
- BDCs make capital investments in middle market companies, which are businesses valued between $10 million to $1 billion. The middle market sector of the economy is responsible for one-third of the private sector GDP and these businesses produce more than $6 trillion in revenues annually.
- BDCs are structured as pass-through entities for tax purposes (Registered Investment Company or RIC), register and sell shares in public offerings under the SEC rules, and generally trade on national exchanges.
- The BDC industry's financing of middle market businesses helps American companies expand and create jobs. Growing businesses across the country rely on BDCs to finance new capital projects such as land, equipment, and facilities.

There are:

- 48 traded BDCs ($139b assets)
- 41 non-traded BDCs ($130b assets)
- 50 Private BDCs ($40b assets)

Issue: Back in 2006, the SEC implemented a rule that required investment companies like BDCs and Mutual funds to disclose their operating expenses and fees on their prospectus fee table. This makes sense for mutual funds, but for BDCs, fees and expenses are already calculated into their reported NET asset value and therefore reflected in the share price. By having to include it again in the prospectus fee table, it is essentially double counted and artificially inflates the BDC's expense ratios.

As a result, some of the indices kicked BDCs off (Russell 3000 and S&P). This had the follow-on effect of a number of institutional investors that were investing in BDCs pulling out of the market. This was a one-two punch that cut off many BDCs from institutional investors and retail investors like you and me, and ultimately reduced the amount of capital available to small businesses.

Legislative Justification: Legislation was reintroduced by Reps. Brad Sherman and Bill Huizenga. H.R. 1379 will make changes to a 2006 Securities and Exchange Commission (SEC) rule for funds that invest in Business Development Companies (BDCs)

This bill would fix the SEC double disclosure issue while not reducing the amount of transparency into BDCs. Acquiring funds (i.e., mutual funds) must disclose their fees in a footnote of the prospectus but pulling it out of the table allows for accurate expense ratios to be calculated. The goal is to get BDCs back on the indices which will bring institutional and retail investors back into the fold. Again, BDCs are a highly transparent industry – they must report on every investment they make.