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November 30, 2015

Mr. Brent J. Fields, Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.,
Washington D.C. 20549-1090

Re: Request for Comment on the Effectiveness of Financial Disclosures about Entities Other Than the Registrant (Release No. 33-9929; 34-75985; IC-31849) – Commission File No. S7-20-15

Dear Mr. Fields:

American Capital Ltd., (American Capital, the “Company” or “we”) appreciates the opportunity to comment on the Securities and Exchange Commission’s (“SEC” or “Commission”) “Disclosure Effectiveness Initiative” on the effectiveness of Regulation S-X requirements on financial disclosures about entities other than the registrant. Specifically, the purpose of this letter is to provide comments on the application of Regulation S-X Rule 3-09, *Separate Financial Statements of Subsidiaries not Consolidated and 50 Percent or Less Owned Persons* (“Rule 3-09”) and, by extrapolation, significant majority-owned subsidiary disclosure requirements under Regulation S-X Rule 10-01(b)(1) and subsidiaries not consolidated disclosure requirements under Rule 4-08(g), to a business development company (“BDC”).

American Capital is a publicly traded non-diversified closed-end investment company that has elected to be regulated as a BDC under the Investment Company Act of 1940, as amended (the “1940 Act”). Investments held by American Capital include controlling equity in buyouts of private companies sponsored by the Company as well as its non-consolidated wholly-owned registered investment adviser, American Capital Asset Management, LLC. American Capital, both directly and through its asset management business, originates, underwrites and manages investments in middle market private equity, leveraged finance, real estate, energy & infrastructure and structured products. American Capital manages \$23 billion of assets, including assets on its balance sheet and fee earning assets under management by affiliated managers, with \$80 billion of total assets under management (including levered assets).

American Capital is subject to Article 6 of Regulation S-X, Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) Topic 946, *Financial Services-Investment Companies* (“ASC 946”) and the SEC Division of Investment Management’s consolidation guidance in IM Guidance Update No. 2014-11 (“IM Update 2014-11”). As such, it is precluded from consolidating any entity other than another investment company that acts as an

extension of its investment operations and facilitates the execution of its investment strategy or an entity that is a controlled operating company that provides all or substantially all of its services to the Company and is required to apply the guidance in Regulation S-X Rules 3-09 and 10-01(b)(1) to unconsolidated significant majority-owned investments and Regulation S-X Rule 4-08(g) to subsidiaries not consolidated.

Relevance of Rule 3-09, 4-08(g) and Rule 10-01(b)(1) Disclosures to BDC Investors

When Congress envisioned the concept of a BDC, it was to encourage the flow of public equity capital to private businesses in the United States and create a bridge that allowed investors access to investments in privately-held domestic middle market operating companies and such operating companies access to funds available in the public market without the need, among other constraints, to meet stringent SEC reporting requirements. Thus, unlike operating companies where the motivation to invest in subsidiaries or equity-method entities is driven by a need for operational and/or synergistic growth and to increase net income, a BDC's motivation is to invest in the debt and equity capital of private companies, including controlled portfolio companies that meet the definition of majority-owned subsidiaries under Rules 3-09 and 10-01(b)(1) and subsidiaries not consolidated under Rule 4-08(g), with the goal of generating capital appreciation and/or dividend and interest income. For investors in a BDC, the investment goal, under the stewardship of the BDC, is to benefit from the income and capital appreciation of investments held by the BDC. Investors and other users of a BDC's financial statements generally evaluate performance based on net operating income, the fair value of investments, net asset value and dividends. The underlying historical financial statements or information of significant majority-owned operating companies or operating subsidiaries not consolidated do not have a direct correlation to these metrics and provide limited benefit to investors in evaluating the BDC. Specifically:

- The investment portfolio of a BDC generally comprises a diverse range of investments ("portfolio companies") and an individual portfolio company with operations that are unrelated to the operations of the BDC does not reflect the environment and operations of the BDC.
- A BDC is able to utilize the expertise of its investment professionals to obtain certain operational benefits related to its portfolio company investments, based on its past and current knowledge of the portfolio company and the industry in which it operates. These benefits are not reflected in historical financial statement information of a standalone portfolio company but rather requires qualitative discussion.
- While the historical financial statement information of a portfolio company prepared under the historical cost basis is an input in the determination of fair value, such information does not encompass all of the relevant inputs that are used to determine fair value based on market participant principals including consideration of forecasted performance or industry comparables, as reflected in the BDC's financial statements.
- Current period interim financial information of a portfolio company, required under Rule 10-01(b)(1), may be presented for a period that lags that of the BDC and therefore is not necessarily indicative of the significance of the portfolio company to the BDC as reflected in its fair value.

- Under paragraph 2400.2 of the SEC FRM, Rule 3-09 financial statements are required for all periods presented if the significance threshold is met in any period presented. Thus, a BDC is required to present Rule 3-09 financial statements for a portfolio company that is no longer significant. This can be confusing or misleading to the users of the BDC's financial statements.

Practical Issues in the Application of Rules 3-09, 4-08(g) and 10-01(b)(1)¹ by BDCs

The application of Rules 3-09 and 4-08(g) tests by an investment company such as a BDC presents many practical issues, specifically:

- The income test under Rule 1-02(w)(3) of Regulation S-X requires a comparison of the registrant's equity in the income of the investee after non-controlling interest to the income of the registrant. It is our understanding that a BDC may compare the change in fair value of, together with income from, its portfolio company instead of the equity in the income of the portfolio company. Therefore, certain portfolio companies that are not significant or material to the BDC's financial statements would nonetheless be considered "significant" under Rule 1-02(w)(3) due merely, for example, to a large amount of unrealized depreciation on one or more other investments (including during any five year period as applicable for Rule 3-09 and Rule 4-08(g) under the computational guidance in Rule 1-02(w)) or due to the impact of macro-economic forces on the fair value of a BDC's investments and therefore its financial results. A large amount of unrealized depreciation on one or more portfolio companies could cause an otherwise insignificant portfolio company, such as a portfolio company that is de minimus on the other two significance tests and historically insignificant on the income test, to be computationally significant under the income test of Rule 1-02(w)(3). The inclusion of Rule 4-08(g) disclosures or Rule 3-09 financial statements for such a portfolio company would not be meaningful and that additional disclosure of immaterial amounts could actually be confusing or misleading to the users of the financial statements².
- The total asset test³ under Rule 1-02(w)(3) of Regulation S-X requires the comparison of the BDC's proportionate share of its portfolio company's total assets, generally determined on a historical cost basis, over the BDC's total assets that are primarily determined on a fair value basis. This is an "apples-to-oranges" comparison that is not meaningful. Furthermore, a highly leveraged portfolio company can mathematically be significant even if it is not material to the BDC.
- Rule 3-09(a) requires separate financial statements for majority-owned subsidiaries, defined in Rule 1-02(n) as "a subsidiary more than 50 percent of whose outstanding voting shares is owned by its parent and/or the parent's other majority-owned subsidiaries" and therefore applies to both directly- and indirectly-held majority-owned subsidiaries. Based on this definition, a BDC holding more than 50% of the outstanding voting shares of an unconsolidated portfolio company that meets the definition of an investment company under ASC 946 (for example, a private equity fund) that does not

¹ The Rule 10-01(b)(1) interim reporting requirement applies to majority-owned subsidiaries for which separate financial statements would otherwise be required for annual periods under Rule 3-09.

² We appreciate that the SEC may waive the disclosure requirements in certain circumstances.

³ The total asset test was eliminated for determining the significance of equity method investees in SEC Final Release No. 33-7118 in December 1994 but continues to apply to majority-owned subsidiaries.

consolidate its majority-owned subsidiaries, is required to look through to its majority-owned indirectly-held portfolio companies for the purpose of determining significance of indirectly-held majority-owned portfolio company under Rule 3-09. It may not be feasible for the BDC to obtain the underlying data to determine the significance of the indirectly-held portfolio company or be in a position to require the preparation of timely financial statements by the indirectly-held majority-owned portfolio company.

- There is an inconsistency in the determination of a subsidiary for the purposes of Rule 4-08(g) as compared to Rule 3-09 (as discussed above). Rule 4-08(g) applies to a “subsidiary” not consolidated which is defined in Rule 1-02(x) as “...an affiliate controlled by such person directly, or indirectly through one or more intermediaries.” We understand that for the application of Rule 4-08(g) by an investment company, a subsidiary is an affiliate as defined by section 2(a)(3) of the 1940 Act, that is controlled by the investment company. Section 2(a)(9) of the 1940 Act defines control as “the power to exercise a controlling influence over the management or policies of the company ...” and incorporates a presumption that 25% ownership of the voting securities of a portfolio company represents control. Furthermore, having a majority of the board seats of a portfolio company is also indicative of control.
- In some cases, a BDC may not control a “majority-owned subsidiary” as defined, for example, if it has an investment in an externally managed fund where the fund manager controls the entity, and therefore may not have the ability to obtain the information required to perform the significance tests or provide the financial information disclosure.
- Under paragraph 2420.8 of the SEC’s Financial Reporting Manual (“SEC FRM”), if a significance threshold is met for any interim period included in a quarterly report, then the registrant is required to present Rule 10-01(b)(1) disclosures for both the current and prior year comparative periods included in the quarterly report. Private companies that are significant subsidiaries of a BDC⁴ may not have the wherewithal to provide historical comparative period interim financial information for the required periods without undue burden.
- Under Rule 3-09, the financial statements of a significant portfolio company are required to be SEC compliant. Further, the financial statements are required to be audited if the significant majority-owned portfolio company meets the income or investment test; an audit is not required if the significant majority-owned portfolio company trips the total asset test. This can result in logistical challenges given the short period of time between the finalization of the annual investment and income tests and the deadline by which the audited financial statements of significant portfolio companies must be completed (absent an extension, this deadline coincides with the BDC Form 10-K filing). This time pressure can result in an additional burden on the portfolio company.

Issues in the Determination of Significance under Rule 1-02(x)

Although the request for comment outlines two of the Rule 3-09 tests, the investment and income tests, as indicated above, the total asset test has been eliminated for equity-method investments but continues to apply to majority-owned subsidiaries not consolidated. Thus, all three

⁴ A BDC differs from an operating company parent which is required to consolidate its majority-owned significant subsidiaries.

tests apply to significant majority-owned portfolio companies held by an investment company such as a BDC. Practical issues in the application of the significance tests under Rule 1-02(x) are exacerbated for BDCs due to the nature of the BDC's business and the practical issues in the application of Rules 3-09, 4-08(g) and 10-01(b)(1) discussed above. Additionally:

- Averaging is not available for the purpose of Rule 10-01(b)(1) so a portfolio company may be mathematically significant for one or more interim periods during a year but would not be significant on an annual basis due to the ability to use five year averaging for the denominator in the income test.
- The total asset test under Rule 1-02(w)(3) requires the comparison of the BDC's proportionate share of its portfolio company's total assets over the BDCs and its *consolidated subsidiaries* total assets. As discussed above, a BDC is generally precluded from consolidating its portfolio companies and the Rule does not contemplate the impact of the assets of all majority-owned portfolio companies on the denominator to create a more meaningful metric (i.e. a BDC is unable to gross up the denominator for assets of other unconsolidated majority-owned significant portfolio companies in order to determine the significance of an individual majority-owned portfolio company).
- A BDC is required to have insight into a portfolio company's financial information on a timely basis in order to determine significance. Unlike operating companies that generally consolidate controlled investees or apply equity method accounting to their significant equity-method investees (and therefore have access to financial information as part of their close process), a BDC is precluded from consolidating an operating company other than one that provides all or substantially all of its services to the BDC. Therefore, portfolio companies that are private companies are not required to and do not generally prepare full interim or annual financial information that are coincidental to the timeline required to determine significance by the BDC. Thus, a timely determination of significance may not be feasible and would add costs that are burdensome to the portfolio company.
- A BDC's net income is dependent on changes in the fair value of its investments that are determined in good faith by its board of directors. The fair valuation process is not fully completed until after the period end which adds to the time and resource pressure on the BDC and its portfolio companies in determining significance and complying with the disclosure requirements. Compliance with the disclosure requirements would require additional resources at the portfolio company that would be costly and put the portfolio company at a competitive disadvantage with its competitors and damage the value of the portfolio company.
- Based on paragraph 2434.2 of the SEC FRM and our understanding of the application of the income test by a BDC, the test compares the change in fair value of a portfolio company together with other income statement items related to the investment such as dividend income (numerator), to the BDC's pre-tax net income (denominator). A negative numerator is treated as an absolute number. The result of this is that depreciation in the fair value of an impaired or worthless portfolio company that is no longer material to the BDC can render it mathematically significant.

Private Company Financial Statement Considerations

In May 2012, the Financial Accounting Foundation created the private company council (“PCC”) with a mandate to improve accounting standards for private companies. The PCC was created to address private company accounting given that accounting standards applicable to public companies may not be relevant or meaningful to private companies especially in light of costs involved.

Significant majority-owned portfolio companies that have elected to follow PCC guidance are required under Rule 3-09 to prepare financial statements in accordance with Rules 3-01 and 3-02 on a timely basis⁵. As such, they would meet the definition of “public business entity” under FASB Accounting Standard Update No. 2013-12⁶ (“ASU 2013-12”) and would become subject to FASB guidance applicable to public companies in respect of financial statements filed or furnished with the SEC. This would put an unfair and onerous burden on a portfolio company especially if it meets the significance test for one year only.

Additionally, private company information is likely confidential in nature such that inclusion of any financial information may be detrimental to the business of the portfolio company and lead to a competitive disadvantage.

Alternative Determination of Significance and Disclosure

As discussed above, BDCs and their significant portfolio companies face significant challenges in preparing the required financial disclosure information on a timely basis. The limited benefit of the financial information disclosures in a BDC environment is outweighed by the onerous burden placed on the portfolio companies that are generally private companies. Investors and other users of a BDC’s financial statements generally evaluate performance based on net operating income, the fair value of investments, net asset value and dividends. Additionally, IM Update 2014-11 specifically addresses the consolidation of a wholly-owned subsidiary⁷ by a BDC and indicates the staff’s belief that a BDC should consolidate such a subsidiary (e.g., a holding company) if its design and purpose may be to act as an extension of the BDC’s investment operations and to facilitate the execution of the BDC’s investment strategy.

It should also be noted that the FASB considered the need for additional disclosure in the financial statements of an investment company in the context of the investment company’s investment in another investment company⁸. Based on feedback from constituents, in April 2014, the FASB

⁵ In accordance with paragraphs 2405.7 to 2405.9 of the SEC Financial Reporting Manual, the maximum timeline for the filing of Rule 3-09 financial statements of a domestic private company investee with a year-end that is coterminous with the registrant is 90 days.

⁶ Under ASU 2013-12, an entity may meet the definition of a public business entity solely because its financial statements or financial information is included in another entity’s filing with the SEC. In that case, the entity is only a public business entity for purposes of financial statements that are filed or furnished with the SEC.

⁷ A wholly-owned subsidiary is defined in Rule 1-02(aa) of Regulation S-X as a subsidiary substantially all of whose outstanding voting shares are owned by its parent and/or the parent’s other wholly owned subsidiaries.

⁸ In November 2006, the FASB issued FSP FIN 46(R)-d, *Application of FASB Interpretation No. 46(R) to Investment Companies* that would have clarified requirements on the consolidation by an investment company holding a controlling interest in another investment company. The FASB decided not to prescribe additional consolidation guidance.

In October 2011, the FASB issued proposed Accounting Standards Update, *Financial Services—Investment Companies (Topic 946): Amendments to the Scope, Measurement, and Disclosure Requirements*. The Exposure Draft would have

determined that the cost of requiring additional disclosure related to information about investments in another investment company outweighed the benefit.

However, we appreciate that additional financial information disclosure under Rules 3-09, 4-08(g) and 10-01(b)(1) may be material or meaningful to the investors in a BDC, to that end, we believe the following amendments to the Rules, specific to an investment company such as a BDC, would be appropriate:

- **Determination of Significance**

- **Income Test:** We believe there should be two income related tests for BDCs:
 - Unrealized appreciation or depreciation when included on a net basis in the denominator of the income test causes volatility and distorts a BDC's net income causing otherwise insignificant portfolio companies to appear significant. We believe appreciation and depreciation should be included as absolute values in both the numerator and denominator to determine significance.
 - Income from operations rather than net income is a more useful metric to investors in a BDC. We believe a BDC's income test should be based on investment income from a majority-owned portfolio company or subsidiary not consolidated as a percentage of the total investment income of the BDC.
- **Total Asset Test:** We believe the total asset test should be eliminated for a BDC's investments in a majority-owned portfolio company and subsidiary not consolidated. The SEC eliminated this test in December 1994 for investments in equity-method investees since a comparison of the investee's total assets to the total assets of the registrant was insufficiently relevant if the investee was less than majority owned and, therefore, its financial statements were not consolidated in the registrant's financial statements. For reasons discussed above, we believe that the asset test is also not relevant for a BDC's investments in majority-owned portfolio companies as it compares a majority-owned portfolio company's total assets determined on a historical cost basis to a BDC's total assets, determined on a fair value basis and unconsolidated.
- **Investment Test:** We agree with the application of this test as it compares the fair value of the majority-owned portfolio company to the total fair value of investments held by the BDC.

- **Threshold for determining Significance**

We believe the thresholds of 20% under Rules 3-09 and 10-01(b)(1) and 10% under Rule 4-08(g) for determining significance are too low. We believe the determination of significance for the tests should be consistent with Regulation S-X Rule 3-05(b)(4)(iii)⁹

required an investment company to consolidate controlling financial interests in another investment company in a fund-of-funds structure.

⁹ Rule 3-05(b)(4)(iii) provides "Separate need not be presented once the operating results of the acquired business have been reflected in the audited consolidated financial statements of the registrant for a complete fiscal year unless such financial

which provides guidance on the separate financial statements of an acquired business that need to be presented by the acquiring entity and currently sets an 80% significance level for determining when an entity is of major significance.

- **Consistent Definition of Significance for Rule 3-09 and 4-08(g)**

As discussed above, Rule 3-09 applies to majority-owned subsidiaries as defined in Rule 1-02(n) whereas, for BDCs, we understand Rule 4-08(g) applies to affiliates as defined by section 2(a)(3) of the 1940 Act. We believe both tests should be consistent and based on significance as discussed above.

- **Use of averaging for the Rule 10-01(b)(1)**

We believe the use of averaging mitigates the potential for an insignificant portfolio company appearing significant to the period results and allows for better monitoring and fewer unexpected results. We therefore believe that the interim significance tests should include averaging based on the comparative year-to-date interim periods for the previous five years consistent with the averaging used for annual financial statements.

- **Require the Financial Information Disclosure only for Period when the Portfolio Company is Significant**

Currently, financial information disclosure is required for all comparative periods presented if a BDC's significant portfolio company was significant in any of the periods presented. The comparative period disclosure is not meaningful and can be misleading to investors as well as costly for the BDC and its portfolio companies. Therefore, we believe financial information disclosure should only be necessary for periods in which the portfolio company is significant.

- **Disclosure**

With respect to BDCs, we believe that the impact to the BDC of the significant portfolio company is relevant and meaningful to the investor rather than the portfolio company's standalone financial information currently required under Rule 3-09, 4-08(g) and 10-01(b)(1). To this end, we believe the following additional disclosure would be meaningful to an investor:

- ***For significant investments in other investment companies as defined in ASC 946:*** In these circumstances, we believe investors would be concerned with the transparency into the risks, obligations and expenses of the significant portfolio company (that is considered an investment company) to which the investor through its investment in the BDC, have economic exposure. Therefore, additional disclosure related to the investments held by the significant portfolio

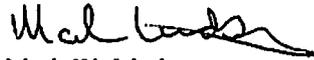
statements have not been previously filed or unless the acquired business is of such significance to the registrant that omission of such financial statements would materially impair an investor's ability to understand the historical financial results of the registrant. For example, if, at the date of acquisition, the acquired business met at least one of the conditions in the definition of significant subsidiary in §210.1-02 at the 80 percent level, the income statements of the acquired business should normally continue to be furnished for such periods prior to the purchase as may be necessary when added to the time for which audited income statements after the purchase are filed to cover the equivalent of the period specified in §210.3-02."

company, similar to those provided on the BDC's Schedule of Investments, would be meaningful to investors.

- *For significant investments in operating companies:* We believe financial information that would be meaningful to investors is the impact of the significant portfolio company on the BDC's results of operations and financial position. For example, a footnote disclosure that identifies the significant portfolio company and details the income statement impact to the BDC, such as appreciation/depreciation¹⁰ and investment income, and provides a qualitative discussion about the business and reason for the significance of the portfolio company. For example, if significance was driven due to a change in fair value, it would be meaningful to an investor to know the specific driver for the change such as historical performance, forecasted performance or industry comparables. This will also alleviate some of the private company challenges discussed above such as providing non-public information that puts the portfolio company at a competitive disadvantage and the time and resource burden on the portfolio company in providing the financial information required.

If you have any questions about these comments, or if we can provide further information, please do not hesitate to contact Mark Lindsey at [REDACTED] or by email at [REDACTED]

Sincerely,



Mark W. Lindsey
Senior Vice President and Controller

¹⁰ This is consistent with the proposed amendment to Schedule 12-14, Investments In and Advances to Affiliates, in the SEC Proposed Rule, *Investment Company Reporting Modernization* (Release Nos. 33-9776; 34-75002; IC-31610; File No. S7-08-15 RIN 3235-AL42) where the SEC has proposed disclosure of "net realized gain or loss for the period" by amending column C of the schedule to rule 12-14.