February 28th, 2020

The Honorable Jay Clayton
Chairman
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

Dear Chairman Clayton:

The undersigned organizations represent American businesses of all sizes and from every industry and geographic region within our economy. We appreciate the ongoing work of the Securities and Exchange Commission ("SEC" or "Commission") to modernize our nation's securities laws and ensure that the U.S. capital markets remain the most competitive, transparent, and liquid in the world. Consistent with this agenda, we write in support of exempting exchange-traded business development companies ("BDCs") from the SEC's 2006 acquired fund fees and expenses ("AFFE") requirement.

While the SEC has occasionally considered adopting such an exemption, we believe the ongoing disruption of the BDC market caused by the AFFE requirement – and the harm that inflicts upon BDC shareholders - justifies the need for prompt action. As you are aware, the SEC using its existing authority to implement an exemption for BDCs from the AFFE requirement has long had the support of a broad spectrum of market participants, members of Congress, and others who have weighed in with the Commission on this critical issue.

The AFFE requirement adopted by the SEC in 2006 was intended to help investors better understand the scope of expenses in registered funds that invest in other funds. However, in practice the AFFE requirement has had the effect of *overstating* the expenses of mutual funds and other registered funds that invest in BDCs. This has resulted in major index providers dropping BDCs from their indices and a decline of institutional ownership in BDCs.

BDCs hold a unique place amongst regulated funds, as they have higher expenses than a traditional closed end fund because it takes more resources to vet and originate the investments BDCs make. BDCs manage their investment portfolios similar to the way an operating company does. Adding the total expenses of the BDC into the expense ratio of a regulated fund (as is currently required under AFFE) effectively 'double counts' the impact in a registered fund's expense ratio. Applying the AFFE rule disclosure to a BDC investment is therefore misleading and inaccurate and is not an "apples to apples" comparison when compared to a closed end fund AFFE disclosure.

Inaction by the SEC to address the well documented harm that AFFE is causing inhibits the ability of BDCs to provide the maximum benefit to small and medium-sized businesses. In 2014 most major index providers– including S&P and Russell – dropped BDCs from their family of indices. In announcing this policy change, Russell cited the "distortive impact" that the AFFE requirements have had on fund expense ratios. This decision means that passively-managed mutual funds and exchange traded funds (ETFs) – which are designed to track the performance of market indices – are effectively prohibited from investing in BDCs. Actively managed funds also now have a disincentive from making BDC investments, as they reasonably conclude that the costs of an overstated expense ratio are too high.

The reduction in investments from mutual funds and ETFs has dramatically reduced institutional ownership of BDC shares and affected secondary market liquidity for BDCs. By one measure, institutional ownership decreased by around 25 percent from 2013 to 2014, when BDCs were removed from the major indices.[1] The average trading volume for BDC shares has also dropped by 50% since 2014.[2] Still, many fund families acknowledge in their SEC filings that the true costs of investing in BDCs are overstated under AFFE.[3]

These outcomes are a classic case of regulatory "unintended consequences" – a rule that was designed to better inform investors has generally done so with the exception of BDCs, where it effectively requires the disclosure of misleading information. It is fully within the SEC's authority to address this problem and exempt BDCs from the AFFE requirement, as it has previously done with similar investment vehicles such as mortgage real estate investment trusts (REITs).

While BDCs and their shareholders have proactively communicated with SEC staff their concerns over the last several years, little progress has been made towards a regulatory solution. However, the

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[1] 2Q18 BDC Scorecard. See also Raymond James, BDC Ownership Percentage by Investor Type (April 2019). The market cap weighted average of BDC ownership by institutional investors plunged by approximately one-quarter year-over-year between the end of Q413 (42.2%) and Q414 (31.7%). This percentage decline increased to approximately 35 percent through Q418 (27.6%). (unpublished report with data sourced from FactSet; institutional holdings for December 31, 2018, and December 31, 2015, excluding holdings from private banks/wealth management firms, brokers and investment banks; and insider holdings.)

[2] Bock, O'Shea and Mazzoli, New SEC Leadership Announced and Hopefully A Fresh Take on an Old Rule, Equity Research (Wells Fargo Securities, LLC) (Sept. 7, 2017), Exhibit 11 – Russell Commentary on BDC Exclusion at 9.

[3] See. e.g. Vanguard Explorer Fund prospectus: *". . . . The expense ratio of a fund that holds a BDC will thus overstate what the fund actually spends on portfolio management, administrative services, and other shareholder services by an amount equal to these Acquired Fund Fees and Expenses. The Acquired Fund Fees and Expenses are not included in a fund's financial statements, which provide a clearer picture of a fund's actual operating expenses."* Hartford Funds family prospectuses: *"Business development company expenses are similar to the expenses paid by any operating company held by a Fund. They are not direct costs paid by Fund shareholders and are not used to calculate a Fund's net asset value. They have no impact on the costs associated with Fund operations."*

Commission's December 2018 proposed rule for "Funds of Funds" specifically sought input on AFFE for BDCs and the public response overwhelmingly and clearly documented the scope of the problem and legally permitted solutions to it. With this public record for rulemaking, we hope the Commission will break the regulatory inertia and move toward a solution.

We respectfully urge the Commission to prioritize this important issue, which will result in BDCs having a greater ability to provide critical financing for Main Street businesses throughout the country.

Sincerely,

Brett Palmer
President
Small Business Investor Alliance (SBIA)

Nelson Griggs
Executive Vice President
Nasdaq

Jason Mulvihill
Chief Operating Officer & General Counsel
American Investment Council (AIC)

Tom Quaadman
Executive Vice President
Center for Capital Markets Competitiveness
U.S. Chamber of Commerce

Tony Chereso
President and CEO
Institute for Portfolio Alternatives (IPA)

Cc: Commissioner Hester M. Peirce
Commissioner Allison Herren Lee
Commissioner Elad L. Roisman