



January 6, 2005

Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-0506

Re: Proposed Rule Changes Relating to the Definition of Eligible Portfolio Company (File No. S7-37-04)

Dear Mr. Katz:

The Investment Company Institute¹ appreciates the opportunity to comment on the Commission's proposed new Rules 2a-46 and 55a-1 under the Investment Company Act of 1940 ("Investment Company Act").² The proposed rules would expand the definition of "eligible portfolio company," thereby increasing the number of companies in which business development companies ("BDCs") may invest.³ The Institute has no objection to the proposed rules as drafted. We may have serious concerns, however, if the definition of eligible portfolio company were otherwise expanded, such as through a market capitalization-based approach.

When Congress amended the Investment Company Act in 1980 to establish BDCs as a new type of closed-end investment company, it emphasized that the primary purpose of BDCs was to make capital and managerial assistance more readily available

¹ The Investment Company Institute is the national association of the American investment company industry. More information about the Institute is included at end of this letter.

² See *Definition of Eligible Portfolio Company under the Investment Company Act of 1940*, SEC Release No. IC-26647 (Nov. 1, 2004), 69 Fed. Reg. 64816 (Nov. 8, 2004), available on the Commission's website at <http://www.sec.gov/rules/proposed/ic-26647.pdf> (the "Proposing Release").

³ Proposed Rule 2a-46 would define the term "eligible portfolio company" to include: (1) any issuer that does not have any class of securities listed on a national securities exchange ("Exchange") or on NASDAQ; and (2) any issuer that has a class of securities listed on an Exchange or NASDAQ but (a) has received notice from the Exchange or NASDAQ that it does not meet the applicable quantitative standards for continued listing and (b) does not satisfy the initial quantitative requirements for listing a class of its securities on any Exchange or NASDAQ. Proposed Rule 55a-1 would conditionally permit a BDC to make follow-on investments in an issuer that met the definition of eligible portfolio company under proposed Rule 2a-46 when the BDC made its initial investment(s) but no longer meets that definition because of having subsequently listed a class of its securities on an Exchange or on NASDAQ.

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to small, developing and financially troubled businesses.⁴ Among other things, Congress required BDCs to invest a significant portion of their assets in eligible portfolio companies, which currently include issuers that do not have a class of securities with respect to which margin credit may be extended under the Federal Reserve Board's margin rules.⁵ According to the Proposing Release, because the definition of eligible portfolio security relies in part on the margin rules, recent changes in the definition of "margin security" by the Federal Reserve Board have had the unintended effect of significantly limiting the investment opportunities of BDCs.⁶

The Proposing Release states that the proposed rules are intended to realign the definition of eligible portfolio company with the purpose intended by Congress when it enacted the legislation creating BDCs.⁷ For this reason, the Institute has no objection to these rules as proposed. We may have serious concerns, however, if the definition of eligible portfolio company were otherwise expanded, such as by linking the definition to an issuer's level of market capitalization. In the Proposing Release, the Commission identified several shortcomings of that approach, including the fact that it is unclear what level of market capitalization would be an appropriate measure of small, developing or financially troubled businesses.⁸ The Institute is additionally concerned that a market capitalization approach could have the potential to expand the scope of eligible investments for BDCs beyond what Congress originally intended. Such an expansion could raise investor protection concerns in light of the special regulatory exemptions that BDCs enjoy under the Investment Company Act. We accordingly recommend that the Commission adopt the rules as proposed and make no further changes to the definition of eligible portfolio company.

* * * *

We appreciate the opportunity to comment on the proposed rules. If you have any questions about our comments or need additional information, please contact me at (202) 326-5824.

Sincerely,

Amy B.R. Lancellotta
Senior Counsel

cc: Paul F. Roye, Director

⁴ See H.R. Rep. No. 1341, 96th Cong., 2nd Sess. 21, 23 (1980).

⁵ Section 2(a)(46)(C)(i) of the Investment Company Act.

⁶ Proposing Release at 64817-18.

⁷ *Id.* at 64818.

⁸ *Id.* at 64819.

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Division of Investment Management
Securities and Exchange Commission

About the Investment Company Institute

The Investment Company Institute's membership includes 8,553 open-end investment companies ("mutual funds"), 633 closed-end investment companies, 141 exchange-traded funds and 5 sponsors of unit investment trusts. Its mutual fund members manage assets of about \$7.830 trillion. These assets account for more than 95% of assets of all U.S. mutual funds. Individual owners represented by ICI member firms number 87.7 million as of mid-2004, representing 51.2 million households.