ABOUT THE SMALL BUSINESS INVESTOR ALLIANCE

The Small Business Investor Alliance (SBIA) is the premier organization of Business Development Companies (BDCs), representing a significant proportion of this growing industry. SBIA’s BDC members provide vital capital to small and medium sized businesses growing nationwide, resulting in job creation and economic growth.

SBIA was formed in 1958 as the National Association of Small Business Investment Companies (NASBIC). Since that time, SBIA has grown significantly, representing not only Small Business Investment Companies (SBICs), but also the entire BDC industry and lower middle market private equity funds and their investors. SBIA currently represents over 200 members nationwide, and is the largest voice for BDCs in Washington, D.C.

The SBIA believes public policies that help small and midsize businesses gain access to capital is crucial to the nation’s economic growth and job creation. The SBIA BDC Modernization Agenda is a guide to how BDCs are making a difference in providing business investment, and some of SBIA’s legislative recommendations which will ensure the continued growth of this valuable industry.
BDC Modernization Agenda

Legislative Recommendations for Members of the 115th Congress
# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>What is a BDC?</td>
<td>1</td>
</tr>
<tr>
<td>What Type of Financings Do BDCs Make?</td>
<td>2</td>
</tr>
<tr>
<td>BDC Growth and Economic Impact</td>
<td>3</td>
</tr>
<tr>
<td>SBIA Legislative Recommendations:</td>
<td></td>
</tr>
<tr>
<td>Modernize Business Development Companies for the 21st Century</td>
<td>6</td>
</tr>
<tr>
<td>Changes to the Tax Code Need to Keep in Mind the Special</td>
<td>8</td>
</tr>
<tr>
<td>Capital Needs of Middle Market Small Businesses</td>
<td></td>
</tr>
<tr>
<td>What Types of Companies Do BDCs Invest In?</td>
<td>9</td>
</tr>
<tr>
<td>Current List of BDCs (As of April 2015)</td>
<td>11</td>
</tr>
<tr>
<td>SBIA Government Relations Team</td>
<td>15</td>
</tr>
</tbody>
</table>
What is a BDC?

Congress created Business Development Companies (BDCs) in 1980 to facilitate capital formation into small- and medium-sized businesses. BDCs give regular people (retail investors) access to investments that were accessible only to the wealthy (accredited investors). BDCs are investment companies that are designed and required to provide loans and management expertise to growing businesses nationwide. 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 (although some BDCs are sold through retail broker-dealer networks and are known as non-traded BDCs). As BDCs are registered public funds, retail investors are eligible to invest in them.

**FAST FACTS ON THE LEGAL STRUCTURE OF BDCS:**

- BDCs are a hybrid between an operating company and an investment company.
- BDCs are structured as a Regulated Investment Company (RIC) for tax purposes.
- BDCs must invest 70% of their assets in certain eligible portfolio companies (active small and mid-sized businesses), with the remaining 30% open to other types of investment.
- BDCs invest in either debt or equity of small and mid-sized businesses.
- BDCs must provide managerial assistance to the companies they invest in.

**What is the difference between a BDC and a traditional private equity fund?**
WHAT TYPE OF FINANCINGS DO BDCS MAKE?

There are currently over 75 BDCs in existence in the U.S. with over $80 billion in assets. BDCs have various investment strategies that run the gamut from debt to equity. BDCs typically make secured/unsecured loans between $10 and $50 million to middle market companies. BDC loans consist of senior secured loans, second-lien term loans, and mezzanine loans. In addition, many BDCs receive a warrant or pure equity as part of the financing.

Traditional lenders, such as banks, are facing increased regulatory burdens and are unable to lend to small and mid-sized businesses, resulting in increased demand for BDC capital. The BDC percentage of leveraged loans is likely to grow significantly given the current regulatory landscape and recent guidance from federal banking regulators curtailing bank involvement in this area. BDCs, including the amount of capital raised, have grown significantly.

The following illustrates the broad spectrum of lending engaged in by BDCs, as opposed to banks and traditional private equity.

![Diagram](source: Jonathan Bock, BDC Analyst, Wells Fargo Securities)
BDC Growth and Economic Impact

The BDC industry is growing rapidly. Currently, BDCs have over $80 billion in outstanding loans in middle market businesses. This financing helps businesses expand and create jobs. Growing companies across the country rely on BDCs to finance new capital projects such as land, equipment, and factories.

State by State BDCs Total Exposure (In Millions)

Data Provided by AdvantageData
FAST FACTS ABOUT BDC GROWTH

- There are currently 79 BDCs in existence and the sector is growing rapidly.
- BDC capital deployed in the form of senior secured loans has increased 6 fold since start of the 08-09 downturn ($9B to $55B).
- There are now 53 publicly traded BDCs, allowing retail investors a chance to purchase shares in the growth of middle market America.

The chart below shows the rapid growth of BDC loan balances after 2010, illustrating the significant growth in BDC lending to middle market companies.

**Estimated Publicly Traded BDC Loan Balances (Mar. 2017)**

![Chart showing the rapid growth of BDC loan balances after 2010.](chart)

Source: Wells Fargo Securities, Thomson Reuters LPC

BDCS INVEST IN “MIDDLE MARKET” COMPANIES

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. 57 percent of middle market companies project positive revenue growth in the next year. Employment growth remains strong, with 42 percent of middle market employers expecting to add jobs. In the middle of 2016, only 37 percent of firms expected to hire\(^1\).

\(^1\) Data compiled by the National Center for the Middle Market [www.middlemarketcenter.org/performance-data-on-the-middle-market](http://www.middlemarketcenter.org/performance-data-on-the-middle-market)
The lower middle market has seen much more consistent employment growth over the past five years when compared to the S&P 500. Lower middle market businesses ended 2016 with a growth rate of 4.5 percent, compared to the S&P 500’s rate of 2.4 percent, up from 2 percent the previous year. A third of survey respondents expect employment will continue to grow.²

<table>
<thead>
<tr>
<th>Percentage of middle market companies that expect to add jobs</th>
<th>Percentage of middle market companies that reported positive revenue growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>2Q'17 42%</td>
<td>2Q’17 57%</td>
</tr>
<tr>
<td>2Q’16 37%</td>
<td>2Q’17 56%</td>
</tr>
</tbody>
</table>

² Data compiled by the National Center for the Middle Market for SBIA’s lower Middle Market Investment Insights 2H 2017, released March 2017

SBIA Legislative Recommendation:

Modernize Business Development Companies for the 21st Century

SBIA recommends passing legislation to make several changes to the Investment Company Act of 1980 to reform and modernize BDC regulations. Modernizing the regulations that impact BDCs will unleash more capital for job creation and business growth and help the industry mature to reach its full potential.

BACKGROUND OF BDC LEGISLATION

BDC modernization legislation would enable BDCs to deploy more capital to small and medium businesses by changing what is known as the “asset coverage ratio.” BDCs are currently limited to a 1:1 debt-to-equity ratio as opposed to banks and other financial vehicles that are often leveraged at a 9:1 ratio or higher. Allowing a modest increase in the leverage would enable BDCs to deploy significantly more capital to small and mid-sized businesses, while simultaneously reducing the risk in their portfolios, as they can invest in lower yielding, lower risk investments and still generate valuable returns to their shareholders.

Modernization legislation also included provisions to streamline the offering, filing, and registration processes for BDCs at the Securities and Exchange Commission (SEC), eliminating significant regulatory burdens, and aligning the BDCs with other traditional operating companies.

SBIA recommends making the following offering reforms as part of BDC modernization legislation:

- **Incorporation by Reference:** Allow BDCs to incorporate already filed information by reference into current registration statements with the SEC. This will streamline disclosure requirements and reduce burdensome, duplicative regulatory paperwork for BDCs, while still ensuring investors would receive relevant and necessary disclosures.

- **WKSI & Shelf Registration:** Allow BDCs to file automatic shelf registration statements and permit them to qualify for Well Known Seasoned Issuer status. These changes will allow BDCs that have a lengthy track record in the market more flexibility and efficiency while seeking to raise capital in the public market by allowing them to time offerings when they will best be received by the market.

- **Communications with Investors:** Allow BDCs to communicate with investors more freely during the preparation and filing periods for a registration statement. This will permit investors to attain access to more information about a BDC during the time in which it is conducting an offering; thus, eliminating unnecessary liability risks for BDCs in the offering process.

- **Research Dissemination:** Allow broker-dealers and others flexibility to disseminate research on BDCs; thereby, better informing the market and shareholders. A number of brokerage firms provide research to their clients, thereby driving investor interest in purchasing BDC shares and creating more capital available to lend to small and mid-size businesses.

- **Safe Harbors for Additional Information:** Provide a safe harbor for BDCs to allow dissemination of additional information during an offering. This safe harbor will allow BDCs to provide investors with updated disclosures or recent developments during the offering process, promoting more expeditious information sharing for investors, while also reducing the cost and time burden of re-circulating lengthy disclosure documents.

- **Synchronize Prospectus Filing Requirements:** Synchronize the prospectus filing requirements to those of other public companies, as was originally contemplated by Congress in 1980. Many other companies are permitted to forgo the immense expense of sending the lengthy final prospectus to all individual investors, and are only required to file it with the SEC and deliver it to those investors that wish to receive it. Allowing BDCs the same option will save millions of dollars in delivery costs, and prevent investors from having to accept lengthy documents that they don’t wish to receive.

- **Regulatory Parity:** Relieve BDCs of the requirement to provide written confirmations of sales, notifications of allocation, and deliveries of securities. Eliminating this requirement, as it has been removed for other companies, will do away with significant regulatory paperwork and permit BDCs more flexibility in the sales process.

- **Investment Adviser Ownership:** Allow BDCs to own investment advisers without having to file an application for exemptive relief. Many BDCs have already received exemptive relief from the SEC, allowing them to own registered investment advisers. Removing the exemptive relief requirement will level the playing field for all BDCs and avoid the legal costs of seeking relief as well as eliminate the lengthy time period that it takes the SEC to approve such requests.
“The Investment Company Act of 1940 places very significant operational restrictions on BDC’s including severely limiting the ability to deploy leverage, restrictions on ownership of registered investment advisers, prohibitions and limitations on many types of joint and affiliated transactions, and requiring extensive public disclosure on everything from its portfolio investments to its financing arrangements.”

—Curtis Hartman, Chief Credit Officer, Main Street Capital, a BDC in Houston, Texas.

“BDCs can fill a larger void for small business capital if Congress modernizes the current BDC regulatory structure. BDCs are currently being held back on their ability to grow their capital structure, with restrictions placed on leverage levels and preferred stock. BDCs are also left at a disadvantage when they offer their securities on market exchanges and in their compliance and reporting responsibilities with the Securities and Exchange Commission (SEC).”

—Tom Aronson, Managing Director, Monroe Capital, a BDC in Chicago, Illinois

“While the BDC industry continues to grow, I strongly believe that we can expand our scope and do more to fulfill our policy mandate. To that end, I am here today on behalf of the BDC industry to express support for current proposed legislation that seeks to make straightforward, prudent changes to the Investment Company Act of 1940 in order to enable BDCs to more easily raise and deploy capital to small and medium size businesses. It is important to note that BDCs are not seeking any government or taxpayer support or subsidy. The BDC industry is simply asking Congress to modernize their regulatory framework so that BDCs can more easily fulfill their Congressional mandate.”

—Michael Arougheti, CEO, Ares Capital Corporation, Testimony before the House Subcommittee on Capital Markets & GSEs, October 23, 2013.
Changes to the Tax Code Need to Keep in Mind the Special Capital Needs of Middle Market Small Businesses

Scale matters, and the special capital needs of smaller businesses need to be at the heart of a broader tax reform conversation. When dealing with our cumbersome tax code, it is very easy to focus on large numbers and not drill down to the effects on smaller businesses. We recommend Congress make a concerted effort to bring pro-growth tax policy to the smaller businesses that make up the middle market.

The nearly 200,000 U.S. businesses that make up the American Middle Market represent one-third of private sector GDP, employing approximately 47.9 million people. Middle market firms have outpaced the S&P 500 in growth each quarter over the last five years and outperformed through the financial crisis (2007–2010) by adding 2.2 million jobs across the United States. Additionally, an August 2017 study found that middle market firms substantially improved the nation’s economic health between 2011 and 2017. Though they account for just 1 percent of all commercially active companies, they are responsible for more than half (51.7%) of total U.S. job growth since 2011, demonstrating their importance to the U.S. economy. These businesses are private and public, family owned, and sole proprietorships, geographically diverse, and span almost every major industry and sector. Their health serves as an indicator for the greater U.S. economy.

SBIA is working to ensure Congress will focus on tax policies that grow small- and medium-sized businesses. Growing businesses should continue to be able to access growth capital via debt or equity without penalty; and therefore, the deductibility of interest expense should be maintained. Given the importance of partnership structures and pass-through income for smaller businesses, we encourage tax reform that recognizes the value of these structures. Keeping capital gains low, if not lower, would be particularly helpful as it relates to smaller businesses, as would preventing changes in the tax treatment of carried interest for smaller private equity funds and reforming small business investing tax provisions.

---

1 Data compiled by the National Center for the Middle Market

2 Data compiled by American Express and Dun & Bradstreet
What Types of Companies Do BDCs Invest In?

BDCs invest in the heart and soul of America, the companies that employ a large part of the American workforce. BDCs invest in a variety of industries and sectors across America including manufacturing, healthcare technology, restaurants, energy companies, aerospace, media companies, IT companies, web technology, cloud-based computing companies, biotech, healthcare services, educational services, consumer products, and many others.

Below is a list of some of the companies receiving financing over the past couple years

**Berry Aviation, Inc.**  
An industry leader in the aviation business  
*San Marcos, Texas*

**BDC Investment:** Berry Aviation, Inc. received $6.3 million in capital investment from Main Street Capital Corporation (SBIA Member, NYSE: MSCA).

**Company Background:** Berry Aviation, Inc. is a leader in private aviation, assisting U.S. Military and Government efforts as well as private companies, NCAA athletic teams, and NASCAR teams. Berry utilizes its fleet of 21 modifiable aircraft to provide mission-specific, critical support around the globe. The company employs 200 and is a two-time winner of the U.S. Small Business Administration’s Award for Excellence.

**Censis Technologies, Inc.**  
A leader in surgical asset management software  
*Franklin, Tennessee*

**BDC Investment:** Saratoga Investment Corporation (SBIA Member, NYSE: SAR) provided an investment of $12.7 million to Censis Technologies.

**Company Background:** Censis Technologies, Inc. provides a flexible portfolio of surgical instrument tracking options using a web-based, user-friendly platform. Censis tracks surgical instrument inventory, notifies users of the dates and types of sterilization techniques used, and even alerts OR technicians if tools are unclean, incompatible, or missing. The Censis suite of scalable solutions allows customers to choose an appropriate mix of services, facilitating an increase in patient safety, OR productivity, tray accuracy, and successful surgeries.
**East West Copolymer & Rubber, LLC**  
A major player in the development and advancement of synthetic rubber technology  
*Baton Rouge, Louisiana*

**BDC Investment:** In October of 2014, East West Copolymer, LLC, received $12,000,000 in investment led by Main Street Capital Corporation (SBIA Member, NYSE: MAIN), which funded $9.6 million of the invested capital, to support East West's working capital and expansion needs.

**Company Background:** East West is a synthetic rubbers manufacturer with its production facility located in Baton Rouge, Louisiana. East West's Styrene-Butadiene-Rubber ("SBR") & Nitrile-Butadiene-Rubber ("NBR") products are primarily used in the production of tires for automobile, industrial, and agriculture applications. The facility was designed and built by the U.S. Government during World War II, and since then has played a major role in the development and advancement in synthetic rubber technology. East West is one of only two independent rubber manufacturing plants in the United States capable of producing SBR.

**ILC Dover, LP**  
A world leader in the innovative design and production of engineered products employing high-performance flexible materials  
*Frederica, Delaware*

**BDC Investment:** Golub Capital BDC, Inc. (SBIA Member, NASDAQ: GBDC) provided $18.4 million in investment in ILC Dover, LP.

**Company Background:** ILC Dover, LP is a world leader in the innovative design and production of engineered products employing air-tight, flexible materials. Best known for its work with NASA and the Apollo missions on the Moon, ILC Dover manufactures spacesuits for the government and the rising private space exploration industry. Along with its products that keep vital oxygen or hazardous viruses contained, ILC Dover utilizes its expertise in structural containment, laminated materials, and soft goods to produce: military and civilian airships, tethered aerostats (ISR), inflatable aerodynamic decelerators (IADs), resilient subway flood gates, tunnel plugs, rafts, radomes, and more.

**TAS Energy, Inc.**  
A leading global provider of diversified modular green energy solutions  
*Houston, Texas*

**BDC Investment:** Hercules Technology Growth Capital, Inc. (SBIA Member, NASDAQ: HTGC) invested $10.9 million in TAS Energy, Inc.

**Company Background:** TAS Energy, Inc. is a clean energy innovator, combining power generation, refrigeration, and packaging in its patented processes to achieve clean, efficient energy solutions. TAS's products deal with needs ranging from hot to cold; it produces power systems based on Waste Heat, which tap into energy trapped in power plant smokestack emissions, as well as Turbine Inlet Chilling systems, devices that increase the efficiency of gas turbines by cooling them in warm climates.
SBIA Government Relations Team

SBIA’s Government Relations Team welcomes the opportunity to talk with you about the impact of BDC investment in your state or district. We have a database of thousands of small and mid-size businesses across the country that have received financing from our member funds. We are eager to work with you to make progress on the SBIA BDC Modernization Agenda.

Brett Palmer  
President  
(202) 628 5055  
bpalmer@sbia.org

Tonnie Wybensinger  
Executive Director, BDC Council  
(202) 628-5055  
tonnie@sbia.org

Will Gardner  
Government Affairs Manager  
(202) 628-5055  
wgardner@sbia.org

Nick Andrews  
Government Affairs Manager  
(202) 628-5055  
nandrews@sbia.org