November 7, 2011

VIA ONLINE SUBMISSION

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: Treatment of Asset-Backed Issuers (Release No. IC-29779; File No. S7-35-11)

Ladies and Gentlemen:

This letter is submitted by Ares Capital Corporation ("ARCC"), a closed-end investment company that has elected to be regulated as a business development company (a "BDC") under the Investment Company Act of 1940 (the "1940 Act"). It is in response to a request for comment by the U.S. Securities and Exchange Commission (the "Commission") on an advance notice of considering proposed amendments to Rule 3a-7 under the 1940 Act, which are described in Release No. IC-29779, published in the Federal Register on September 7, 2011 (the "Concept Release"). All terms used in this letter which are not specifically defined herein are as defined in the Concept Release.

We commend the Commission for understanding that more input from market participants is needed before the Commission determines to address its concerns under Rule 3a-7. Moreover, we appreciate the opportunity to comment on the Concept Release.

We have limited our comments to those issues that relate specifically to BDCs regulated by the Commission. Specifically, and as discussed below, ARCC is submitting comments addressing the inclusion of issuers relying on Rule 3a-7 for an exemption from the 1940 Act ("3a-7 Issuers") in the definition of "eligible portfolio company" under the 1940 Act.

Discussion

The Commission sets out in the Concept Release its understanding of the purpose of the 1980 amendments to the 1940 Act (the Small Business Investment Incentive Act of 1980 or the

"SBIIA")[1] which created the regulatory framework for BDCs. The brief recitation highlights that BDCs were primarily established to make capital more readily available to small, developing and financially troubled businesses[2] and secondly to make available significant managerial assistance to those businesses. The Commission notes that Congress attempted to define these specific businesses in its definition of "eligible portfolio company" contained in Section 2(a)(46) of the 1940 Act. ARCC agrees generally with the concepts briefly set out in the Concept Release describing the legislative creation of BDCs, but respectfully disagrees with the Commission's interpretation of the guidance provided by Congress when it enacted the SBIIA, specifically with respect to the Commission's statement that it does not believe that 3a-7 Issuers are the type of businesses in which Congress intended BDCs to invest.

The purpose specifically stated by Congress for creating the BDC framework in the SBIIA was to "[p]ermit business development companies to raise funds from both public and private sources and remove unnecessary statutory impediments to their entrepreneurial activities consistent with investor safeguards."[3] Congress specifically recognized throughout the legislative process that the SBIIA sought to "remove burdens on venture capital companies that might create unnecessary disincentives to the legitimate provision of capital to small businesses."[4] Congress indicated that reductions in regulatory burdens also must be balanced against undermining investor confidence by observing principles of fiduciary duty.[5] These themes were continued in subsequent amendments to the 1940 Act aimed at providing BDCs with greater flexibility in a number of respects in an effort to stimulate additional investment in small, developing and financially troubled businesses.[6]

Central to the mission of BDCs is the definition of "eligible portfolio companies," or those companies that should primarily benefit from the SBIIA. Section 2(a)(46)(B) of the 1940 Act requires that an eligible portfolio company, among other things, be "neither an investment company as defined in [S]ection 3 [of the 1940 Act] ([other than certain small business investment companies]) nor a company which would be an investment company except for the

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1 Small Business Investment Incentive Act of 1980, Pub. L. No. 96-477, 94 Stat. 2275 (1980) (codified at scattered sections of the United States Code) ("SBIIA").

2 We note that the legislative history of the SBIIA refers to the companies intended to be financed by BDCs differently throughout (*e.g.*, "smaller, unseasoned and growing companies," "small, growing businesses," etc.). For purposes of this letter, we use the description provided in the Concept Release.

3 S. Rep. No. 958, 96th Cong., 2d Sess. 3 (1980) ("Senate Report").

4 H.R. Rep. No. 1341, 96th Cong., 2d Sess. 21-22 (1980) ("House Report") and Senate Report at 5.

5 Senate Report at 5.

6 S. Rep. No. 1815, 104th Cong., 2d Sess. 43 (1996) (Prepared Statement of Arthur Levitt, Jr., Chairman of the Securities and Exchange Commission). The 1996 amendments to the 1940 Act created a new class of small portfolio company to which BDCs are not required to provide managerial assistance; permitted BDCs to acquire more freely securities of portfolio companies from persons other than the portfolio company or its affiliates, potentially increasing liquidity of such securities; and provided BDCs with greater flexibility in their capital structure.

exclusion from the definition of investment company in [S]ection 3(c) [of the 1940 Act]...." The plain language of the Section does not exclude an entity from being an eligible portfolio company if it relies on an exemptive rule under Section 3(a) for its exclusion from the definition of investment company. Congress specifically indicated that the carve out from Section 2(a)(46)'s definition of eligible portfolio company applicable to investment companies should be read narrowly and stated that "[S]ection 2(a)(46)(B) requires that, with one exception, an eligible portfolio company be neither an investment company as defined in [S]ection 3 of the Act nor a company which is excluded from the definition of investment company *solely* by [S]ection 3(c) of the Act [emphasis added]."[7] A structured finance vehicle under Rule 3a-7 is not an investment company and, depending on the facts and circumstances, may be a conduit to provide capital to small, developing and financially troubled businesses, notably to companies that are themselves eligible portfolio companies for a BDC. As a result, it does not follow that Congress would have intended an absolute limit on the use of such vehicles when, for example, the underlying companies receiving the financing from the 3a-7 Issuer are eligible portfolio companies.[8] ARCC believes, and the legislative history supports the view, that the exclusion of investment companies and companies relying on a Section 3(c) exemption from the definition of eligible portfolio company reflects Congress' primary concern to restrict BDC's investments in financial institutions, rather than an intention to circumscribe the means for implementing or facilitating investments, whether directly or indirectly, in otherwise eligible portfolio companies.[9]

Congress provided the Commission with rulemaking power in Section 2(a)(46) to create additional categories of eligible portfolio companies. Congress specifically indicated that the purpose of this power was to "enable the Commission through the administrative process to *broaden*, if appropriate, the category of eligible portfolio company [emphasis added]."[10] It is not apparent that Congress intended to give the Commission the authority to restrict the categories of companies within the "eligible portfolio company" definition and, in turn, BDCs' ability to provide capital to small, developing and financially troubled businesses.

In the Concept Release, the Commission stated that it presently does not believe that 3a-7 Issuers are the type of small, developing and financially troubled businesses in which Congress intended BDCs to invest. The Commission, however, has not provided in the Concept Release any explanation for its present belief, which appears to deviate from the Division of Investment

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7 Senate Report at 15.

8 Congress amended the 1940 Act 11 times after the adoption of Rule 3a-7. If Congress had intended to make *all* 3a-7 Issuers ineligible to be qualifying investments for BDCs, there has been ample opportunity to amend the definition of eligible portfolio company to effect this change. Congress, however, has not taken this action.

9 Senate Report at 15 ("This requirement ensures that the business development company will invest in operating companies rather than investing in other financial institutions. For example, an eligible portfolio company could not be a broker, bank or insurance company."). See also S. Rep. No. 1815 at 43 (expanding BDC ability to purchase eligible portfolio companies from others).

10 House Report at 31 and Senate Report at 16.

Management's view of structured finance articulated in its 1992 study of the 1940 Act.[11] That study set out the blueprint for Rule 3a-7. In the study, the Division of Investment Management recognized that structured finance is primarily a "financing technique that integrates the capital markets with borrowers seeking access to those markets" and contrasts it to investment companies, which "are intended to provide the advantages of professional management, diversification and economies of scale to investors."[12] An investment in a 3a-7 Issuer that provides financing to eligible portfolio companies could enable a BDC to fulfill its Congressional mandate to provide access to capital to small, developing and financially troubled businesses, as opposed to providing the BDC with a professionally managed mutual fund, which is clearly not an eligible portfolio company. ARCC respectfully disagrees with the Commission's belief that 3a-7 Issuers are *per se* not the type of companies intended to be included within the definition of eligible portfolio company, and submits that any such belief should be substantiated with appropriate evidence before being acted upon by the Commission. The Commission's unsubstantiated statement may have the practical effect of restricting BDCs' investment in 3a-7 Issuers in a manner that is not required by the 1940 Act.

ARCC believes that if the Commission were to adopt rule amendments with respect to BDCs of the type suggested in the Concept Release without further evidence to support the Commission's stated belief, there could be a conflict with Section 2(c) of the 1940 Act, because the Commission would not have properly considered why this rule amendment would be in the public interest or whether such action would promote efficiency, competition, and capital formation. The Administrative Procedure Act[13] requires any rules adopted by the Commission to be invalidated if the agency action is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law."[14] As the U.S. Court of Appeals for the District of Columbia Circuit recently observed, "the Commission has a unique obligation to consider the effect of a new rule upon 'efficiency, competition, and capital formation,' and its failure to 'apprise itself—and hence the public and the Congress—of the economic consequences of a proposed regulation' makes promulgation of the rule arbitrary and capricious and not in accordance with law."[15] ARCC respectfully submits that the Commission has not provided any information to the public in the Concept Release to satisfy this obligation and instead is seeking to limit the statutory definition of eligible portfolio company based solely on an unsubstantiated belief. This is particularly concerning given that an investment in a 3a-7 Issuer by a BDC could further the explicit goals of the SBIIA and express Congressional intent.

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11 See Protecting Investors: A Half Century of Investment Company Regulation (May 1992).

12 Protecting Investors at 76-77.

13 5 U.S.C. § 551 et seq.

14 5 U.S.C. § 706(2)(A).

15 See Business Roundtable, et. al. v. SEC, Fed. Sec. L. Rep. ¶96,358 (D.C. Cir. Jul. 22, 2011) (citing 15 U.S.C. §§ 78c(f), 78w(a)(2), 80a-2(c) and Chamber of Commerce v. SEC, 412 F.3d 133, 143 (D.C. Cir. 2005); Pub. Citizen v. Fed. Motor Carrier Safety Admin., 374 F.3d 1209, 1216 (D.C. Cir. 2004) (rule was arbitrary and capricious because agency failed to consider a factor required by statute)).

Moreover, ARCC respectfully submits that, prior to making certain of the policy statements in the Concept Release, the Commission did not sufficiently study the BDC industry and the ways in which BDCs can (and currently do) invest in small, developing and financially troubled businesses through a 3a-7 Issuer. In fact, the Commission has not indicated that it sought any evidence that a BDC's investment in a 3a-7 Issuer would not increase the capital available to small, developing and financially troubled businesses. Nor has the Commission considered whether a blanket exclusion of 3a-7 Issuers from the definition of eligible portfolio company will cause unintended consequences in the BDC industry. Instead the Commission has proposed a broad prohibition on a BDC's ability to treat this type of vehicle as an eligible portfolio company or to look through it and treat underlying investments which otherwise satisfy the requirements of Section 2(a)(46) of the 1940 Act as eligible portfolio companies, even though Congress has never specifically restricted the investment in structured finance vehicles by BDCs in this manner. Without an in-depth study of the BDC industry and its use of 3a-7 Issuers, the Commission has no means to know whether a more narrowly tailored rule would be better suited to enable BDCs to meet the Congressional mandate of promoting investment in small, developing and financially troubled businesses.

ARCC also submits that prior to taking any further action to change the definition of eligible portfolio company to exclude 3a-7 Issuers, the Commission should more clearly articulate the investor protections that the Commission would seek to uphold in making such change. Investor protection is the only factor that Congress specifically identified in the SBIIA to be balanced against the Congressional purpose of facilitating the provision of capital to small, developing and financially troubled businesses.[16]

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We appreciate the opportunity to present our concerns to the Commission. We would be pleased to discuss with you and other members of the Commission's staff any aspect of this letter. Questions may be directed to me at (212) 710-2191 or Miriam Krieger at (310) 201-4100.

Respectfully submitted,

Joshua Bloomstein
General Counsel
Ares Capital Corporation

16 Senate Report at 3.