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November 7, 2011

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U.S. Securities and Exchange Commission
Attention: Ms. Elizabeth Murphy, Secretary
100 F Street, N.E.
Washington, DC 20549-1090

Re: File No. S7-35-11: Treatment of Asset-Backed Issuers under the Investment Company Act

Dear Ms. Murphy:

Attached are the joint comments of Gladstone Capital Corporation and Gladstone Investment Corporation on the above-captioned rule-making. Per the instructions in the concept release, we are enclosing the original and two copies of the comment letter.

Very truly yours,

Eric S. Purple

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Re: File No. S7-35-11: Treatment of Asset-Backed Issuers under the Investment Company Act

Ladies and Gentlemen:

We represent Gladstone Capital Corporation and Gladstone Investment Corporation (the "Funds" or the "Gladstone Funds"), each of which is a closed-end management investment company that has elected to be regulated as a business development company (a "BDC") pursuant to Section 54(a) of the Investment Company Act of 1940 (the "1940 Act").[1]

The Gladstone Funds welcome the opportunity to comment on the Commission's recently issued concept release entitled "Treatment of Asset-Backed Issuers under the Investment Company Act.[2] In particular, the Funds wish to provide their views as to whether Rule 3a-7 under the 1940 Act should be amended to expressly provide that an entity relying on that rule is not an "eligible portfolio company" within the meaning of Section 2(a)(46) of the 1940 Act.

As discussed more fully below, the Gladstone Funds believe that securitization vehicles that are formed by a BDC, and that rely on Rule 3a-7 under the 1940 Act ("Rule 3a-7 Issuers"), can serve as an important adjunct to the BDC's provision of capital to small businesses, and that they do so in a manner that is in accordance with Congressional intent. The Funds believe that BDCs should be permitted to continue to treat investments in these

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[1] The contents of this letter reflect the views of the Gladstone Funds, and do not necessarily reflect the views of K&L Gates or its other clients.

[2] SEC Rel. No. IC 29779 (Aug. 31, 2011) (the "Release").

entities as "eligible portfolio companies" under Section 2(a)(46) of the 1940 Act, and urges the Commission to avoid rulemaking that would prohibit BDCs from doing so.

I. The Regulation of BDCs and the Requirement to Invest in Eligible Portfolio Companies

In 1980, Congress passed the Small Business Investment Act of 1980, which was intended to amend the federal securities laws so that business enterprises, particularly small growing and financial troubled enterprises, could more readily raise needed capital in a manner consistent with investor protection.[3] Title I of the Act (the "BDC Amendments") amended the 1940 Act to provide for a new regulatory structure to govern BDCs. This new legislation was designed principally to encourage the formation of BDCs to facilitate investment in small and developing companies. The legislation sought to achieve this goal by generally exempting BDCs from the provisions of the 1940 Act "in favor of a carefully tailored pattern of regulation that takes into account the special needs of such companies, while at the same time preserving important investor protections."[4]

The effect of the BDC Amendments was to subject BDCs to regulation under the 1940 Act identical to registered closed-end funds in many instances, and to subject BDCs to modified regulation in other areas. In determining how the 1940 Act should be applied to BDCs, Congress determined that certain provisions of the 1940 Act should be inapplicable to BDCs given the nature of their operations,[5] and in other areas determined that a new regulatory approach unique to BDCs was appropriate.[6]

A clear theme runs throughout the legislative history of the BDC amendments, and in the text of the legislation itself: Congress intended the benefits provided by the BDC Amendments to apply narrowly to those entities that are bona fide BDCs, and that act as such. Congress implemented this policy goal by imposing objective and subjective investment limitations on a BDC's investment activities in order to ensure the flow of capital

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3 See H.R. No. 96-13411, 1980 U.S.C.C.A.N. 4801 (Sept. 18, 1980)

4 H.R. No. 96-13411, 1980 U.S.C.C.A.N. 4804 (Sept. 18, 1980).

5 See, e.g., H.R. No. 96-13411, 1980 U.S.C.C.A.N. 4803-4804 (Sept. 18, 1980) (Stating that the legislation "seeks to remove burdens on venture capital activities that might create unnecessary disincentives to the legitimate provision of capital to small business.")

6 See Section 57 of the 1940 Act (Regulating, in pertinent part, transactions between BDCs and certain other parties); Section 55 of the 1940 Act (Imposing investment restrictions on BDCs).

to small business.[7] Collectively, these limitations have the effect of requiring a BDC to invest a significant portion of its assets in the securities of "eligible portfolio companies."

The term "eligible portfolio company" is defined in Section 2(a)(46), in pertinent part, as an issuer that (a) is organized under the laws of, and has its principal place of business in, the U.S.; (b) is neither an investment company as defined in section 3 of the 1940 Act[8] nor a company which would be an investment company except for the exclusion from the definition of investment company in section 3(c)[9] of the 1940 Act; and (c) meets certain size requirements.[10]

II. Status of Rule 3a-7 Issuers as Eligible Portfolio Companies

Rule 3a-7 Issuers are neither investment companies (pursuant to the terms of Rule 3a-7 itself), nor are they excluded from the definition of investment company pursuant to Section 3(c).[11] As a result, as long as they meet the other requirements for being an eligible portfolio company, Rule 3a-7 Issuers fit squarely within the definition of eligible portfolio company.

Not withstanding this fact, the Commission states in the Release that it does not believe that "Rule 3a-7 issuers are the type of small, developing and financially troubled businesses in which Congress intended BDCs primarily to invest."[12] The Commission has

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7 Section 2(a)(48) of the 1940 Act imposes a subjective test on the operations of a BDC, and requires the BDC to be "operated for the purpose of making investments in securities described in paragraphs 1-3 of Section 55(a)" of the 1940 Act. Similarly, Section 55(a)(1)-(3) imposes an objective test. The section makes it unlawful for a BDC to purchase any asset, other than assets described in Sections 55(a)(1)-(7) of the Company Act, unless at the time of purchase, the value of the BDC's assets described in paragraphs (1)-(6) of that section equals or exceeds seventy percent of the value of the BDC's total assets.

8 This exclusion does not include a small business investment company that is licensed by the Small Business Administration to operate under the Small Business Investment Act of 1958 and which is a wholly-owned subsidiary of the BDC.

9 Section 3(c) excludes from the definition of investment company a broad range of entities that are engaged in the business of investing, reinvesting or holding securities, and includes, among others: private investment pools that rely on Section 3(c)(1) or 3(c)(7); broker-dealers that rely on Section 3(c)(2); and banks and insurance companies that rely on Section 3(c)(3).

10 An issuer must also meet the requirements of Section 2(a)(46)(C) or Rule 2a-46 under the Investment Company Act in order to be deemed to be an Eligible Portfolio Company.

11 The exemptive authority of rule 3a-7 is not based upon Section 3(c). Instead, the authority of Rule 3a-7 comes from the general exemptive and rulemaking authority granted to the Commission under Sections 6(c) and 38(a) under the 1940 Act. See *In re* Exclusion from the Definition of Investment Company for Structured Financings, SEC Release No. IC-19105 (Nov. 19, 1992).

12 Release at p. 44.

requested comment on "whether Rule 3a-7 should be amended to provide expressly that an issuer relying on Rule 3a-7 is an investment company for purposes of the definition of eligible portfolio company under the Investment Company Act."[13]

If the Commission were to implement such an approach with respect to Rule 3a-7 Issuers that are sponsored or formed by a BDC, the sponsoring BDC may be limited in its ability to invest not only in the securities of the 3a-7 issuer itself, but in other non-qualifying assets that help it to fulfill its mission of lending to small business.[14] As discussed below, this would have the effect of denying a BDC an effective tool to provide financing to small businesses, undermining Congressional intent in this area.

III. Use of Securitization Vehicles by BDCs.

The Gladstone Funds believe that Rule 3a-7 Issuers that are formed and sponsored by a BDC would provide additional liquidity to the BDC and would facilitate an increase in lending to small businesses.[15] Broadly speaking, BDCs exist to provide capital to small business. These investments are often illiquid, however, and as a result it is difficult for a BDC to exit these investments and redeploy its capital to make new loans to new companies. If a BDC were to sponsor a Rule 3a-7 Issuer, however, it could securitize a portion of these illiquid loans. In doing so, the BDC would receive cash for these investments, which could then be redeployed as new loans to small business, and allow the BDC to retain an interest in the pool of loans through its equity ownership of the Rule 3a-7 Issuer.

The investment of a BDC in a Rule 3a-7 Issuer in this manner is fully consistent with Congressional intent, and BDCs should be permitted to continue to treat such investments as an investment in an eligible portfolio company. In order to sponsor a Rule 3a-7 Issuer, a BDC must first obtain the loans with which it will form the vehicle. To do so, a BDC would make loans to eligible portfolio companies in accordance with Sections 2(a)(46) and 55(a) of the 1940 Act. These loans would then be used to create the securitization vehicle that relies on Rule 3a-7. The cash proceeds of the securitization, coupled with the residual interest in the Rule 3a-7 Issuer, would compensate the BDC for the loans. The BDC would then be free

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[13] Id.

[14] See H.R. No. 96-13411, 1980 U.S.C.C.A.N. 4821-4823 (Sept. 18, 1980) (noting importance of non-qualifying assets to further the BDC's ability to provide financing to small business).

[15] The Gladstone Funds are aware that some BDCs may be interested in investing new capital in Rule 3a-7 Issuers that the BDC does not sponsor. The Gladstone Funds take no position on the treatment of these investments under Section 2(a)(46).

to relend the cash to other eligible portfolio companies in accordance with Sections 2(a)(46) and 55(a) of the 1940 Act.[16]

The Gladstone Funds firmly believe that these types of securitization arrangements further the Congressional intent underlying the BDC Amendments of providing capital to small operating companies. This type of securitization investment effectively allows a BDC to increase the amount and velocity of funding that it provides to eligible portfolio companies, which is precisely the type investment activity that Congress intended to foster.

In addition, Rule 3a-7 Issuers that are sponsored by a BDC are not analogous to the type of investments in other financial entities that Congress sought to discourage. In sponsoring a Rule 3a-7 Issuer, the BDC does not divert its cash away from small operating companies that are in need of capital in favor of an investment in another entity that will, in turn, invest the money in other issuers. Rather, the BDC directs its cash directly to small operating companies, securitizes the resulting loans, and then relends the resulting proceeds. In this context, the securitization of the loans in a Rule 3a-7 Issuer acts as the functional equivalent of the BDC selling a portion of its assets in order to redeploy its lent capital. This arrangement furthers the intent of Congress, it does not retard it, and it should not be limited through an amendment to Rule 3a-7.[17]

IV. Conclusion.

For the reasons set forth above, the Gladstone Funds believe that any attempt to limit the ability of a BDC to treat a Rule 3a-7 Issuer that it has formed as an eligible portfolio security should draw a bright and clear distinction between Rule 3a-7 Issuers generally and Rule 3a-7 Issuers that are sponsored or created by a BDC as a tool to increase its ability to make the investments in small operating companies that Congress wished to facilitate.

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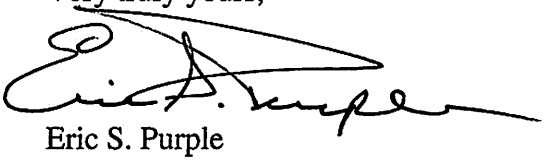
[16] A BDC could still offer up significant managerial assistance to the companies whose securities are held by the Rule 3a-7 Issuer.

[17] We note that treating Rule 3a-7 Issuers that are sponsored by a BDC as eligible portfolio companies is consistent with the position taken by the Commissions staff that a BDC can treat certain investments in Section 3(c) entities as investments in eligible portfolio companies provided that the purpose of those entities is to further the BDC's legitimate investment activities. See NGP Capital Resources Company (Pub. Avail. Dec. 28, 2007).

On behalf of the Gladstone Funds, we thank you for the opportunity to comment on this important issue.

Very truly yours,



Eric S. Purple

cc: David Gladstone