Thomas Aronson of Monroe Capital explains why, In its search to find capital access solutions, Congress should modernize BDC regulations.

The policy discussion in Congress about improving access to capital for small businesses is not new. While many small businesses continue to access capital from large or small community banking sources, the demand for capital is being unmet for a number of thriving small businesses. In fact, according to a third-quarter 2013 survey released by Pepperdine University, 60% of the businesses had difficulty raising new external financing.

In order to improve the conditions for small business financing, Congress should look at the options on the table to modernize the regulatory structure of Business Development Companies (BDCs). BDCs were created by an act of Congress in 1980 to facilitate capital formation for small business to fill a need that wasn't being met by other financial institutions.

While the capital that BDCs provide to small businesses is only a small part of the overall market for small business financing, the total assets of BDCs has grown to $53.7 billion from 68 active BDCs. Since 2012, BDCs have grown capital for small businesses by raising approximately $4.0 billion of follow-on equity offerings, $1.2 billion in convertible debt offerings and $1.8 billion in retail debt offerings.

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).

Most BDCs agree that we've been playing an uneven regulatory playing field with other seasoned issuers, and that we need to stick together in order to provide more punch in Washington. That is why on October 7, my firm, Monroe Capital Corporation, joined 23 other BDCs to write to the SEC to request a modernized regulatory environment. The petition for rulemaking, organized by the Small Business Investor Alliance, asks the SEC to reform the registration and offering regulations for BDCs.

Many of the current arcane restrictions on BDCs need to be fixed to make the capital-raising process more flexible, more efficient, and less expensive. For example, we are asking for Congress and the SEC to allow BDCs to obtain "well-known seasoned issuer" (WKSI) filing status with the SEC, which makes filing a registration statement faster. Other public companies can obtain WKSI status, but the SEC has not allowed this status for BDCs.

We've also asked to be allowed to pre-file shelf registration statements with the SEC for continuous or delayed offerings. This would merely allow BDCs to have the SEC review registration statements in advance of accessing the public markets. The shelf registration allows continuous offerings, or multiple offerings, based on the same registration. The primary advantages of a shelf offering are timing and certainty, and the benefits will be passed on to small businesses trying to access capital.

We've also put forward some modest proposals to improve the ability of BDCs to raise capital by making changes to the asset coverage ratio and the regulatory treatment of preferred stock. The proposal allowing BDCs to borrow up to $2 of debt per $1 of equity would provide BDCs an opportunity to meet more of the small business demand for capital. We firmly believe that under certain circumstances BDCs should be allowed to take on new leverage. Increasing the BDC leverage to a modest 2:1 ratio would still be well below other financial institutions.

The BDC proposals we support have been formally introduced in Congress: H.R. 31 by Representative Nydia Velazquez (NY-7), and H.R. 1800 by Rep. Michael Grimm (NY-11). Congress held a hearing in late October in the House Financial Services Committee to take a look at these reforms and subsequently held a markup to pass the Grimm legislation.

I will note that there are still small questions from the SEC and Congress about the legislation as it is currently written. We agree there can be some revisions to the legislation to allow for greater disclosures and protections for investors, and we thank Representative Carolyn Maloney (NY-12) for raising many of these issues during the Committee discussion.

Congress took the first step by passing a bill out of the Committee, but there are many further steps that need to be taken to usher this bill through the Senate. We hope for the continued attention of Congress, but more importantly that Congress moves forward in a productive and bipartisan way. BDCs are ready and eager to take on an expanded role in providing growth capital for small businesses. TSL

Thomas Aronson is managing director of Monroe Capital LLC. He is also BDC Committee Chair of Small Business Investor Alliance.

[1] Pepperdine University Private Capital Index, PCA Index Survey Third Quarter 2013, http://bschool.pepperdine.edu/appliedresearch/research/pcmsurvey/content/q3_2013_pca_index.pdf