



FRANKLIN SQUARE
CAPITAL PARTNERS

Franklin Square Holdings, L.P.
2929 Arch Street, Suite 675
Philadelphia, PA 19104

November 11, 2011

VIA E-mail <pubcom@finra.org> and Overnight Delivery

Ms. Marcia E. Asquith
Office of the Corporate Secretary
Financial Industry Regulatory Authority, Inc.
1735 K Street NW
Washington, DC 20006

Re: FINRA Regulatory Notice to Members 11-44

Dear Ms. Asquith:

On September 29, 2011, the Financial Industry Regulatory Authority, Inc. (“FINRA”) published Regulatory Notice 11-44 seeking comments on its proposal to amend NASD Rule 2340 regarding the reporting of per share estimated values on customer account statements (the “Proposed Amendment”). This comment letter is submitted on behalf of FS Investment Corporation and FS Energy and Power Fund (together, the “FS Entities”) by Franklin Square Holdings, L.P., the sponsor of the FS Entities. The FS Entities are non-traded business development companies (“BDCs”) that are offering shares pursuant to effective registration statements on Form N-2 filed with the Securities and Exchange Commission (the “SEC”). As direct participation programs (“DPPs”), and like non-traded real estate investment trusts (“REITs”), the FS Entities’ organization and offering expenses, including selling commissions and dealer manager fees, are regulated by FINRA Rule 2310.

In this letter, we request that FINRA clarify the application of the Proposed Amendment to entities such as BDCs that are already **required** under the Investment Company Act of 1940 (the “1940 Act”) to calculate and publish a net asset value (“NAV”) per share. We request that FINRA address the following issues relating to the Proposed Amendment:

- 1) The Proposed Amendment has the unintended consequence of disproportionately impacting the different types of investment funds regulated under NASD Rule 2340 (such funds, collectively, “2340 Funds”). As a result, we respectfully request:
 - *Because (a) many 2340 Funds are not regulated under the 1940 Act and therefore are not required to establish an NAV, and (b) the NAV of BDCs is not equivalent to intrinsic value, BDCs (and other investment funds which periodically report NAV) should be allowed to use the net offering price rather than NAV on the same basis as other 2340 Funds on customer account statements during the Initial Offering Period.*

- *Because 2340 Funds would be encouraged to shift fees away from items required to be deducted from the net offering price on the customer account statement to other fees charged by them, including acquisition fees, the Proposed Amendment should require that such fees be deducted from the net offering price during the Initial Offering Period in the same fashion as offering expenses.*
 - *Because many 2340 Funds are not required to disclose their NAV, FINRA and the SEC should require them to regularly and periodically calculate and disclose their NAV in a manner consistent with Accounting Standards Codification Topic 820, Fair Value Measurements and Disclosure ("ASC Topic 820"). We believe that this important information should be furnished to potential investors so that they may make an informed investment decision.*
- 2) The Proposed Amendment would require trail commissions to be deducted in full from the net offering price during the Initial Offering Period.
- *We request that FINRA modify the Proposed Amendment to reflect that an issuer is only required to deduct from the net offering price during the Initial Offering Period amounts paid by investors as commissions or other fees at the time of the purchase of the security. We believe that the better policy is to encourage trail commission structures.*

Set forth below is background information regarding BDCs, the Proposed Amendment and a more fulsome discussion of the issues described above.

Business Development Companies

BDCs are regulated under the 1940 Act and were created by Congress in order to facilitate the flow of capital to private businesses and smaller public companies and to allow individual investors to access investments in such enterprises. BDCs have become an attractive vehicle for investors as they are subject to the strong investor protections of the 1940 Act, including:

- 1) regular determination of NAV per share and reporting of this NAV per share in quarterly reports on Form 10-Q and annual reports on Form 10-K;
- 2) prohibition on issuing any shares at a price, net of selling commissions and dealer manager fees, below its then-current NAV per share;
- 3) limitations on the amount of leverage permitted to be incurred, with BDCs being limited to a debt-to-equity leverage ratio of no greater than 1:1;
- 4) prohibitions on many transactions among and between affiliated entities;
- 5) the requirement that the board of directors have a majority of independent members;

- 6) the requirement that the investment advisory contracts of externally advised BDCs be approved by shareholders or the independent directors of the board on a regular basis and such contracts be terminable without penalty and on not more than 60 days' notice;
- 7) the requirement to maintain investments with a third party custodian;
- 8) the antifraud provisions under the 1940 Act;
- 9) with respect to investment advisers of BDCs, the antifraud provisions and extensive regulation under the Investment Advisers Act of 1940; and
- 10) specific, standardized and significant public disclosure requirements with respect to investments, operations, and management.

Few, if any, of these investor protections are required of 2340 Funds that are not regulated by the 1940 Act. In addition to the requirements of the 1940 Act, BDCs are subject to the Securities Act of 1933 and the Securities Exchange Act of 1934, including regulation under the Sarbanes-Oxley Act of 2002, which require extensive and expansive disclosure of information to investors. As a result of their non-traded structure, public offerings by non-traded BDCs, including the FS Entities, are also subject to regulation at the state level, which provides investors with additional protections, including with respect to disclosure.

Proposed Amendment

The Proposed Amendment will revise NASD Rule 2340 to replace the existing language of NASD Rule 2340(c) with a new provision which states that during the Initial Offering Period (as defined in the Proposed Amendment), "any estimated per share value based on the offering price must reflect a deduction of the amount of organization and offering expenses, as defined by FINRA Rule 2310(a)(12)." FINRA Regulatory Notice 11-44 notes that "[i]f any organization and offering expenses are to be deducted from portfolio assets or income, then under the proposal the net estimated value would have to reflect those deductions that will be taken during the Initial Offering Period, in addition to the deduction for organization and offering expenses paid out of proceeds from the offering."

After the Initial Offering Period, the Proposed Amendment would (1) require that customer account statements reflect "a per share value estimated value calculated based on an appraisal of the assets, liabilities and operations of the DPP or REIT" and (2) permit, but not require, a customer account statement not to reflect "a per share estimated value if the most recent annual report of a DPP or REIT does not contain a per share estimated value that complies with the requirements in ...[Section 2340(c)(1)(C) of the Proposed Amendment]."

Footnote 9 of FINRA Regulatory Notice 11-44 acknowledges that some non-traded REITs calculate a daily NAV per share and offer to sell and purchase shares during the continuous public offering at prices based on the daily NAV calculation. It states, in relevant part, "under the proposal, the net estimated value required on customer account statements for such programs

would be the NAV and could not include any commissions, nor any other organization or offering expense associated with the offering.”

Comment to the Proposed Amendment

The FS Entities provide the following comments on the Proposed Amendment:

1) **Disproportionate Impact.** While many view “direct participation programs” and “non-traded REITs” as synonymous, in practice, multiple types of investment funds with differing structures, regulatory frameworks and investment mandates are governed by Rule 2340 and thus impacted by the Proposed Amendment. However, the Proposed Amendment would have a disparate impact on the differing products governed by Rule 2340.

- a) **Most 2340 Funds are not required to establish an NAV.** Since the Proposed Amendment contemplates the use of published NAV when available and non-1940 Act regulated 2340 Funds are not required to publish an NAV, BDCs would be forced to use NAV rather than net offering price during the Initial Offering Period. Additional complications arise as BDCs are prohibited by the 1940 Act from issuing shares at a net share price below NAV. The effect of the Proposed Amendment would result in shares of a BDC being marked at a lower price on customer statements than non-1940 Act regulated 2340 Funds even in a situation where ‘value’ was equivalent, simply due to BDCs being regulated under the 1940 Act and consequently having to disclose NAV on a regular basis.

While certain non-1940 Act regulated 2340 Funds, namely daily NAV-priced REITs, do disclose NAV, non-traded BDCs (including the FS Entities) are fundamentally different and clearly distinguishable from these daily NAV-priced REITs. Footnote 9 states that the net estimated value required on customer account statements for daily NAV-priced non-traded REITs would be the NAV and could not include any commissions, nor any other organization or offering expense associated with the offering. This requirement seems appropriate for daily NAV-priced non-traded REITs, since they are intended to be perpetual-life entities and voluntarily provide liquidity not through a liquidity event but through daily redemptions made possible by the daily NAV pricing. Like an open-end fund, a daily NAV-priced REIT stands ready to redeem shares at the NAV price, and as a result it is appropriate for that value to be included on customer account statements. Non-traded BDCs, on the other hand, expect to provide a liquidity event to shareholders following the completion of the BDC’s offering stage rather than through daily redemptions and, while non-traded BDCs may voluntarily offer to redeem a limited number of shares from time to time at a percentage (usually 90%) of the offering price per share (rather than NAV), any limited redemptions offered by non-traded BDCs to their shareholders are not meant to be the primary source of liquidity for investors.

In addition, the Proposed Amendment provides no background or guidance on how NAV is to be calculated for non-traded REITs that use a daily NAV pricing structure for their offerings, as such daily NAV-priced REITs are not subject to the 1940 Act requirements

regarding how NAV for BDCs is to be calculated. Rule 2a-4 of the 1940 Act sets forth the guidelines for a BDC's calculation of NAV. Assets must be valued on the basis of market value, if available; in the absence of a readily ascertainable market value for an asset, the board of directors must in good faith determine the "fair value." Since daily NAV-priced REITs are not subject to similar statutory requirements on how their NAV is to be calculated, such REIT-determined NAV values will likely result in different methodologies being used by different daily NAV-priced REITs. The FS Entities request that FINRA clarify this issue and require a uniform methodology for determining per share estimated value to be disclosed on customer account statements, taking into account the nuances of the various types of investment vehicles that would be covered by the Proposed Amendment.

Because of this, despite the superficial resemblance to daily NAV-priced REITs because of the periodic NAV calculation, non-traded BDCs more closely resemble a traditional non-traded REIT since they, like non-traded REITs, offer illiquid securities and intend to seek a liquidity event for investors to realize the ultimate market value of the shares offered. The NAV calculation done by BDCs, in contrast to daily NAV-priced REITs, is performed because of 1940 Act requirements, not for market-making purposes. *The FS Entities request that FINRA clarify that Footnote 9 should not be interpreted to include BDCs and that BDCs should be permitted to use the net offering price rather than NAV on the same basis as other 2340 Funds on customer account statements during the Initial Offering Period.*

- b) **The NAV of BDCs is not equivalent to intrinsic value.** The NAV determined by BDCs is intended to approximate the value per share of the assets of the BDC that would be received following the satisfaction of all liabilities in the event of a liquidation of the BDC's assets. NAV does not include any value per share attributable to the BDC as a going concern. This is inconsistent with the policy behind FINRA Regulatory Release 09-09, which instructs issuers to determine the estimated per share value on a customer account statement based on an appraisal not just of the issuer's assets, but also its ongoing operations. Similarly, the Proposed Amendment expressly requires that a customer account statement include a per share estimated value based on an appraisal of the assets, liabilities and operations of an organization. With respect to the FS Entities, value attributable to the operations of the BDC could be significant given, for example, the prior performance of the funds and the investment sub-advisory relationships with subsidiaries of The Blackstone Group, L.P., namely GSO / Blackstone Debt Funds Management LLC and GSO Capital Partners LP, which provides the FS Entities with extensive experience and expertise in sourcing, evaluating and structuring transactions.

The calculation of NAV does not purport to be an approximation of the "intrinsic value" of the BDC, it is not a reflection of the future cash flows to be received by the BDC and it is not the equivalent of an appraisal of the assets, liabilities and operations of the BDC. Since March 31, 2000, a survey of 19 publicly listed BDCs shows that those BDCs have traded at a maximum premium of 107.5% and a maximum discount of 91.8% to their NAV. If a BDC's NAV as calculated under the 1940 Act represented the intrinsic value

of the BDC's shares, their traded per share price would track NAV very closely, with material fluctuations resulting from systemic, market-wide events. As a result, the FS Entities submit it would be inappropriate to use the NAV determined by BDCs in accordance with the 1940 Act as a proxy for the estimated per share value of the BDC to be disclosed on customer account statements. *Therefore, the FS Entities request that FINRA allow BDCs to use the net offering price rather than NAV on the same basis as other 2340 Funds on customer account statements during the Initial Offering Period.*

- c) **Certain fees charged by 2340 Funds should be deducted from the net offering price under the Proposed Amendment.** Some 2340 Funds pay significant regular acquisition fees. The Proposed Amendment does not address whether such regular fees should be included as a deduction to net offering price disclosed on customer account statements during the Initial Offering Period. By not including such regular fees, the Proposed Amendment might encourage certain 2340 Funds to shift fees away from items that are included in the Proposed Amendment (e.g., dealer manager fees paid to the affiliated dealer manager) to items that are not included in the Proposed Amendment (e.g., acquisition fees paid to the affiliated investment adviser). This could easily result in affiliated dealer managers running their operations as a loss leader, with the affiliated adviser obtaining increased funds from acquisition fees. *The FS Entities recommend that FINRA avoid this result and propose a comprehensive set of amendments to its rules that would fully address all such fees and ensure that such fees are included in the estimated per share value to be disclosed on customer account statements during the Initial Offering Period.*
- d) **Non-1940 Act regulated 2340 Funds are not required to disclose their NAV.** The Proposed Amendment relies on the assumption that non-1940 Act regulated 2340 Funds will voluntarily make available, on a regular and periodic basis, their estimated value calculated based on an appraisal of their assets, liabilities or operations following the Initial Offering Period. Non-1940 Act regulated 2340 Funds are not subject to any requirement to periodically disclose the value of their assets, liabilities and operations or their NAV. Under the Proposed Amendment, the repercussion of a non-1940 Act regulated 2340 Fund failing to disclose such estimated value after the Initial Offering Period is that the investor's account statement would show no value for its holdings in the non-1940 Act regulated 2340 Fund. This result seems perverse given that one of the goals of the Proposed Amendment is to provide more information to investors. *As the SEC has the ability to require additional disclosure from non-1940 Act regulated 2340 Funds, the FS Entities request that FINRA work with the SEC in developing an appropriate periodic reporting requirement, including a uniform methodology for determining and disclosing the estimated value of non-1940 Act regulated 2340 Funds in a manner consistent with ASC Topic 820.* We believe that this important information should be furnished to potential investors so that they may make an informed investment decision. Without any such requirement, the Proposed Amendment would not as effectively serve its intended purpose.

- 2) **Trailing Commissions.** FINRA has previously approved “trail commissions,” in which the selling commissions are paid over time instead of up-front at the time of investment to encourage FINRA members to share in their customers’ investment risks. The FS Entities support both FINRA’s decision to permit trailing commissions and the policy behind it. However, the Proposed Amendment would eliminate any incentive for an issuer to provide for a trailing commission. Trailing commissions, as FINRA has noted, are paid by the program from program cash flows during its operation. Further, certain trail commission structures could be “contingent” and based on performance requirements and/or investors not selling their shares. The Proposed Amendment would require that any organization and offering expenses, including the entire trailing commission, be deducted in full from the offering price per share in determining the estimated per share value on a customer account statement during the Initial Offering Period, since the trailing commission would be paid by the program from the program’s portfolio assets or income. As a result, an issuer would not be incentivized to structure its selling commission as a trailing commission, despite the alignment of investment risks between the member and the customer that the trailing commission would create and which FINRA has previously acknowledged. In addition, contingent trails (which may never get paid) could be required to be deducted from the offering price without ever being paid. *The FS Entities therefore request that FINRA modify the Proposed Amendment to reflect that if an issuer uses a trailing commission structure, the issuer only be required to deduct from the net offering price during the Initial Offering Period amounts paid by investors as commissions or other fees at the time of purchase of the security.*

Finally, we request that if FINRA decides to move forward with implementing the Proposed Amendment, a reasonable transition period be included to provide affected issuers operating prior to the effective date of the Proposed Amendment sufficient time to develop appropriate processes, procedures and investor education tools to effectively address the final version of the Proposed Amendment. Existing 2340 Funds were developed, structured, marketed and sold under the current account statement rule. These 2340 Funds will not be in a position to promptly change their distribution methodology and fee structure to adequately address the final implementation of the Proposed Amendment. Without having a properly structured product to sell to investors that takes into account the final implementation of the Proposed Amendment, existing 2340 Funds would likely not be able to effectively compete with new products that were developed taking into account the nuances of the Proposed Amendment. *The FS Entities request that FINRA revise the Proposed Amendment to permit 2340 Funds operating on the effective date of the Proposed Amendment to have a period of no less than 18 months following the effective date to comply with the new rule.*

Ms. Marcia E. Asquith

November 12, 2011

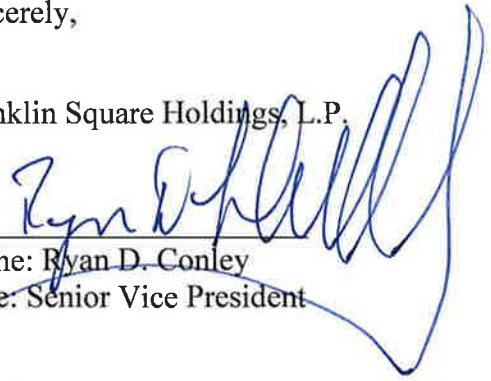
Page 8

We appreciate the opportunity to provide input on the Proposed Amendment. As there are only 4 non-traded BDCs that have registered and been declared effective by the SEC to sell securities, with an additional 7 non-traded BDCs that have pending registrations but have not yet been declared effective by the SEC, we do not believe that FINRA will receive many substantive comments that identify the issues with the Proposed Amendment as it relates to BDCs. We have provided alternative arguments regarding various facets of the Proposed Amendment and believe that BDCs present a unique instance where alternative and clarifying treatment would be appropriate.

Thank you for your consideration.

Sincerely,

Franklin Square Holdings, L.P.

By: 

Name: Ryan D. Conley

Title: Senior Vice President

cc: Mr. Michael C. Forman, Franklin Square Holdings, L.P.
Mr. Gerald F. Stahlecker, Franklin Square Holdings, L.P.
Mr. Stephen Sypherd, Franklin Square Holdings, L.P.
Ms. Adrienne Hart, FS² Capital Partners, LLC