

MEMO# 6090

July 28, 1994

INSTITUTE TESTIFIES ON SMALL BUSINESS LEGISLATION; OPPOSES EXEMPTIONS TO 1940 ACT

July 28, 1994 TO: BOARD OF GOVERNORS NO. 67-94 FEDERAL LEGISLATION COMMITTEE NO. 17-94 FEDERAL LEGISLATION MEMBERS NO. 14-94 SEC RULES COMMITTEE NO. 85-94 RE: INSTITUTE TESTIFIES ON SMALL BUSINESS LEGISLATION; OPPOSES EXEMPTIONS TO 1940 ACT _____ On July 26th, Institute President Matthew P. Fink testified before the Telecommunications and Finance Subcommittee of the House Energy and Commerce Committee on S. 479, the "Small Business Incentive Act." This legislation was introduced by Senate Securities Subcommittee Chairman Christopher Dodd (D-CT) and passed by the Senate last year. The Institute expressed its support for the basic objective of the bill, which is to provide capital to small businesses. The Institute expressed concern, however, that certain provisions of the bill would unnecessarily weaken investor protections that are provided under the Investment Company Act of 1940 and that "any proposal to compromise these investor protections must be approached with caution." Noting that the mutual fund industry already provides more than \$31 billion of capital for small businesses through over 100 small-company funds, Fink stated, "The ability of investment companies to provide this capital is in large part due to the strong investor protections provided by the federal securities laws and the public confidence that they have engendered." In particular, the Institute objected to certain aspects of the proposed exemption from the Act for certain pools of securities held exclusively by "qualified purchasers." Mr. Fink stated that "although the bill is designed to assist small businesses, it would not require these unregulated pools to invest any of their assets in securities issued by small businesses. Thus, these unregulated funds could invest 100% in large companies listed on the New York Stock Exchange, or 100% in foreign securities, without any investment in small businesses. If the capital needs of small business underlie the broad exemption provided by S. 479, then Congress should ensure that these pools actually do provide capital to small businesses by restricting their portfolio holdings to securities of smaller business enterprises and other appropriate investments."

-2- The Institute also objected to the grant of broad rulemaking authority to the SEC to define such a "qualified purchaser." The Institute believes that this grant could result in the offering of unregulated pools of securities to an unnecessarily large and potentially unsophisticated class of investors. The Institute also expressed concerns about the proposed amendments to the business development company ("BDC") provisions of the Investment Company Act which would have the effect of converting BDCs into passive investment vehicles similar to traditional investment companies, thus calling into question the special treatment they receive under the '40 Act. Finally, the Institute expressed concern about another proposal, to create so-called "managerial strategic investment

companies," ("MSICs") which would also be exempt from many provisions of the Investment Company Act. SEC Commissioner J. Carter Beese, Jr., testifying for the Commission, stated that S. 479 promotes growth while maintaining investor protection. The Commission believes the bill would assist venture capital formation and funding by creating a new financing vehicle for highly sophisticated investors, and by streamlining the regulation of "private" investment companies. Commissioner Beese expressed concern about the broad exemptions that would be granted to MSICs, but indicated that Congress may want to consider very narrow exemptions to MSICs in order for MSICs to accomplish their goals. Barry Guthary, on behalf of the North American Securities Administrators Association ("NASAA"), expressed NASAA's guarded support of S. 479, noted that S. 479 has no direct connection to small business and may be used to create unregulated hedge funds. Copies of the Institute's, the SEC, and NASAA's testimony are attached. We are happy to respond to any questions and will keep you informed of further developments. For additional information, please call the Legislative Affairs Department at 202-326-5890. This memo can also be found on FUNDS, the Institute's Fund User Network and Delivery System, under "Legislative Affairs; Washington, Update." Julie Domenick Senior Vice President Legislative Affairs Attachments

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.