

**MEMO# 4628**

March 23, 1993

## **INSTITUTE TESTIMONY ON S.479, THE "SMALL BUSINESS INCENTIVE ACT OF 1993"**

March 23, 1993 TO: BOARD OF GOVERNORS NO. 22-93 SEC RULES COMMITTEE NO. 27-93  
RE: INSTITUTE TESTIMONY ON S.479, THE "SMALL BUSINESS INCENTIVE ACT OF 1993"

The Institute recently submitted written testimony to the Subcommittee on Securities of the Senate Committee on Banking, Housing, and Urban Affairs on S.479, the "Small Business Incentive Act of 1993." The bill, sponsored by Senator Dodd, is very similar to legislation introduced last year at the request of the SEC on which the Institute also submitted testimony. (See Memorandum to Board of Governors No. 28-92 and SEC Rules Committee No. 26-92, dated May 4, 1992.) A copy of the Institute's statement on S.479 is attached. The Institute's statement expresses strong support for the basic objective of S.479, which is to promote capital formation for small businesses. The testimony notes that registered investment companies have served as a significant source of capital for small businesses. In addition, the testimony states, the SEC's recent actions to increase the amount of illiquid securities that a mutual fund may hold and its proposal to permit the creation of "interval funds" should increase further the ability of investment companies to provide capital to small businesses. The testimony indicates that the Institute generally supports these efforts. With respect to the proposed legislation, however, the testimony expresses the Institute's concern that certain of its provisions would unnecessarily weaken investor protections that are provided under the Investment Company Act of 1940. In particular, S.479 would add a new section to the Investment Company Act to exempt pools of securities held exclusively by "qualified purchasers" from the definition of investment company under the Act. The bill as currently proposed would delegate to the SEC the authority to define the term "qualified purchaser," based on certain factors to be set forth in the statute. The Institute's testimony states that this discretionary grant is too broad, and could result in the offering of unregulated pools of securities, including pools not investing in small businesses, to a potentially large and relatively unsophisticated class of purchasers. The Institute's statement recommends that the "qualified purchaser" standard be set forth in the statute and, specifically, that the minimum statutory standard be based on the definition of "qualified institutional buyer" in Rule 144A under the Securities Act of 1933. The Institute's testimony also expresses concerns about the bill's proposed amendments to the business development company ("BDC") provisions of the Investment Company Act. These amendments would (1) permit BDCs to purchase securities of eligible portfolio companies in the secondary market (rather than from the issuer or its affiliates, as is currently required), and (2) relieve BDCs of the requirement to make available significant managerial assistance to eligible portfolio companies. The Institute's testimony states that these proposed changes 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 Investment Company Act. Frances M. Stadler Assistant Counsel Attachment

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