

MEMO# 3742

May 4, 1992

INSTITUTE STATEMENT ON THE "SMALL BUSINESS INCENTIVE ACT OF 1992"

May 4, 1992 TO: BOARD OF GOVERNORS NO. 28-92 SEC RULES COMMITTEE NO. 26-92 RE: INSTITUTE STATEMENT ON THE "SMALL BUSINESS INCENTIVE ACT OF 1992"

As we previously reported, the Securities and Exchange Commission had submitted to Congress a legislative proposal entitled the "Small Business Incentive Act of 1992." (See Memorandum to Board of Governors No. 20-92 and SEC Rules Committee No. 15-92, dated March 25, 1992.) At the request of the SEC, this legislation was introduced in the Senate and the House and was the subject of a Senate Banking Securities Subcommittee hearing on March 26. The Institute submitted written testimony on the bill. A copy of the Institute's statement is attached. In its testimony, the Institute expressed support for the underlying objectives of the bill, which is designed to promote capital formation of small business. However, the Institute expressed concern about certain provisions which could unnecessarily weaken investor protection and recommended that the bill be modified so that it could still achieve its goal without adverse impact on investor protection. Set forth below is a summary of the changes recommended by the Institute. The "Qualified Purchaser" Exception - The Institute recommended that the proposed exception under the Investment Company Act for investment pools whose shares are owned exclusively by "qualified purchasers" be amended to include a statutory minimum threshold amount with respect to who constitutes a "qualified purchaser." Specifically, the Institute recommended that a "qualified purchaser" be required to meet at least the dollar threshold in the definition of "qualified institutional buyer" contained in Rule 144A under the Securities Act, which is defined generally as an institutional investor that owns or invests on a discretionary basis at least \$100 million in securities. This would ensure that shares in these investment pools were being offered to those most capable of assessing and bearing the investment risk. Section 3(c)(1) - The bill would amend Section 3(c)(1) of the Investment Company Act to exempt all non-investment companies from the "look through" provisions for purposes of applying the 100 investor limit thereunder. The Institute recommended that the bill be modified so that all functionally equivalent securities pools will, like investment companies, remain subject to the "look through" provisions of Section 3(c)(1). Business Development Companies - The Institute opposed the proposed changes to the provisions governing "business development companies (BDCs)" that would (1) relax the requirement of a BDC to make available significant managerial assistance in certain instances and (2) allow a BDC to purchase shares in the secondary market. The Institute expressed concern that these changes would have the effect of transforming these entities into the functional equivalent of traditional investment companies, yet exempt from many of the important investor protection provisions of the Investment Company Act. Interval Funds - In its statement, the Institute

suggested that an additional way of promoting small business capital formation would be to allow investment companies to offer shares that are redeemable on a periodic basis less frequent than daily (e.g., monthly, semi-annually, etc.), since the securities of small businesses are often less liquid than those purchased by funds that are required to redeem their shares on a daily basis. * * * We will keep you informed of developments on this legislation. Amy B.R. Lancellotta Associate General Counsel Attachment

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