

MEMO# 5356

November 23, 1993

SENATE PASSES SMALL BUSINESS LEGISLATION

November 23, 1993 TO: BOARD OF GOVERNORS NO. 110-93 SEC RULES COMMITTEE NO. 107-93 RE: SENATE PASSES SMALL BUSINESS LEGISLATION

The Senate recently passed S. 479, the "Small Business Incentive Act of 1993". The bill is designed to promote capital formation for small businesses. A copy of the bill, as passed by the Senate, is attached. As you may recall, the Institute submitted written testimony on S. 479 in which we expressed strong support for the basic objectives of the bill. We expressed concern, however, about several provisions in the bill that we believe would unnecessarily weaken investor protections that are provided under the Investment Company Act. (See Memorandum to Board of Governors No. 22-93 and SEC Rules Committee No. 27-93, dated March 23, 1993.) In particular, the Institute expressed concern about the provision to 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. As proposed, the bill would have delegated to the SEC the authority to define the term "qualified purchaser," based on certain factors to be set forth in the statute. The Institute expressed concern that this broad discretionary grant could result in the offering of unregistered pools of securities, including pools not investing in small businesses, to a potentially large and relatively unsophisticated class of purchasers. Therefore, the Institute recommended 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" under Rule 144A under the Securities Act of 1933. S. 479 was modified to include minimum statutory standards similar, but not identical, to the definition of "qualified institutional buyer". The bill, however, also grants the SEC broad authority to except persons from the Investment Company Act who do not meet those standards, taking into consideration the factors set forth therein. The provisions in the bill to amend the business development company ("BDC") provisions in the Investment Company Act, about which the Institute expressed concern, remained unchanged. Specifically, 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 expressed concern that these changes would have the effect of converting BDCs into passive investment vehicles similar to traditional investment companies, yet exempt from many of the important investor protection provisions in the Investment Company Act. Amy B.R. Lancellotta Associate Counsel Attachment

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