FINAL REPORT
OF THE
SEC GOVERNMENT-BUSINESS FORUM
ON
SMALL BUSINESS CAPITAL FORMATION

June 1994

This report has been compiled by the staff of the Division of Corporation Finance, U.S. Securities and Exchange Commission. The views and recommendations in this report, however, are those of the Forum participants and not of the Commission, the Commissioners or any of the Commission's staff members.

PREFACE

In 1993, the Government Business Forum on Small Business Capital Formation met in Washington, D. C. in accordance with a determination made by the Executive Committee that the Forum would continue to meet in the Nation's Capital frequently and most probably every other year. The recommendations from the 1993 Forum follow. As usual, many thoughtful proposals were developed. The participants gave careful consideration to the many issues encompassed there and others, in the hope that the needs of small business might be accommodated, in balance with appropriate and necessary governmental regulations to safeguard the public interest. We thank them for their efforts and are pleased to present this report.

The Executive Committee for
the Twelfth Annual SEC
Government-Business Forum on
Small Business Capital Formation

EXECUTIVE COMMITTEE

Chair: Mary E. T. Beach
Senior Associate Director
Division of Corporation Finance
Securities and Exchange Commission

Janice Booker
Director, Customer and Industry Affairs
Office of Comptroller of the Currency

Victor Coppola
Director, National Emerging Business Services
Coopers & Lybrand

Raymond J. DeAngelo
Director of Professional Affairs
Association for Investment Management and Research

Jerry Feigen
Adjunct Professor, Georgetown University, School of Business;
President, Jerry Feigen Associates

Seymour Fiekowsky
Assistant Director (Business Taxation)
Office of Tax Analysis, Department of Treasury

John Paul Galles
Executive Vice President
National Small Business United

Dee R. Harris
Director, Arizona Securities Division
(Representative of the North American Securities Administrators Association)

John J. Huntz, Jr.
Senior Vice President
Vista Resources, Inc.

Stanley Keller
Palmer and Dodge
(Representative of the American Bar Association)

Charles Ludlam
Counsel, Senate Committee on Small Business

E. Burns McLindon
Councilor, Buchanan & Mitchell
(Representative of the American Institute of Certified Public Accountants)

Peter McNeish
President, National Association of Small Business Investment Companies

John J. Motley, III
Vice President
National Federation of Independent Business

Allen Neece
Neece, Cator & Associates, Inc.
(Representative of the National Venture Capital Association)

Douglas F. Parrillo
Senior Vice President, Communications
National Association of Securities Dealers

Martha Scanlon
Assistant Director, Division of Research and Statistics
Board of Governors of the Federal Reserve System

Herbert Spira
Tax Counsel
Independent Bankers Association of America

Diane Thomas
Vice President
National Association of Investment Companies

Wayne Upton, Jr.
Project Manager
Financial Accounting Standards Board

September 9, 1993
PANEL MEMBERS

Moderator --
Jerry Feigen, Adjunct Professor
Georgetown University, School of Business;
President, Jerry Feigen Associates
9443 Hickory Limb
Columbia, Maryland 21045

Panelists --
Dr. Les Levine, Chief Executive Officer
Fusion Systems Corporation
7600 Standish Place
Rockville, Maryland 20855

Dr. Alex Severinsky
PAICE R&D
10904 Pebble Run Drive
Silver Spring, Maryland 20902

Cabell Williams, President
Allied Investment Corporation
1666 K Street, N. W.,
Suite 901
Washington, D. C. 20006

Mike Gustafson, General Manager
Cass County Electric Cooperative
491 Elm Street
P. O. Box 8
Kindred, North Dakota 58051

September 10, 1993
PANEL MEMBERS

Moderator --
Marc H. Morgenstern, Esq.
Kahn, Kleinman, Yanowitz & Arnson
2600 Tower at Erie View
Cleveland, Ohio 44114

Panelists --
Mary E. T. Beach, Esq.
6543 Jay Miller Drive
Falls Church, Virginia 22041

Stanley Keller, Esq.
Palmer and Dodge
One Beacon Street
Boston, Massachusetts 02108

1993 FORUM STAFF

Richard K. Wulff

Gerald L. Werner

William E. Toomey

Twanna M. Young

Regina A. Baker

Melissa L. Kimps

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Rule 147 should be amended to eliminate the requirement that the issuer be incorporated within the state where the offer is being made; that the residence of purchasers, not offerees, control the intrastate nature of the offering; reduce the 80% within the state use of proceeds requirement to permit, for example, the purchase of equipment from a business located in another state; and introduce a good faith and substantial compliance standard.

The SEC should use the authority under Section 3(b) to create a regional offering exemption (which would allow an intrastate type exemption for a region even though the region may cross state lines.)

The SEC should develop a set of safe harbors to the provision prohibiting general solicitation as set forth in Regulation D. Example of Safe Harbor: The following shall not be considered as general solicitation: a. Preexisting relationship between offerer and offeree, b. Investment fairs or electronic bulletin boards, c. When you believe that a party mailed materials to would qualify as an accredited investor.

Regulation D should be amended to permit solicitations up to 100 investors and the maximum number of unaccredited investors should be raised from 35 to 50.

Accredited investor status under Rule 501(a)(3), covering certain corporations and charitable organizations, should be attained with total assets in excess of $1,000,000 rather than $5,000,000.

Additional individual accredited investors should be defined but based on the ability of the investor to sustain the complete loss of the investment but not tied to the investors net worth or income levels.

The Rule 144 holding period for the sale of restricted securities should be reduced from 2 years to one year.

The Commission should consider establishing minimum amounts of disclosure which, when made in an offering document, would create a safe harbor for the issuer, under Rule 504 for example.

The SEC tombstone rule permitting certain abbreviated but protected written notices before and during the registration period should be reviewed. The advertisement should indicate what the company does.

A Business Development Company (BDC) would be the ideal vehicle for investing in Small Corporate Offering Registration (SCOR) and Rule 504 stock except that there is no clear regulation on how to value these types of securities

in their portfolios. Therefore the SEC should formulate valuation guidelines for BDC portfolio stocks.

The Financial Accounting Standards Board (FASB) rule to require companies to expense the value of stock options should not be adopted.

Legislation penalizing frivolous securities fraud lawsuits by raising standards of proof and shifting legal costs to unsuccessful litigants should be adopted.

Damages in securities cases should be based on separate and proportionate liability. Proportional liability should be the rule as a means of limiting the risks of the professional advisor acting in good faith.

Securities Exchange Act of 1934

The SEC should encourage and work with the National Association of Securities Dealers (NASD) and the Exchanges and coordinate those activities with the states to make it possible for every public company, especially service companies, to have their stock traded on an organized exchange or NASDAQ (NASD's Automated Quotation System), by, for example, developing standards other than asset base and net worth for listing.

The NASD should publicly support and parallel the American Institute of Certified Public Accountants (AICPA) position that SEC Practice Section membership is the sole criteria for determining qualification of CPA's to perform SEC accounting work.

The Commission should review the requirements of the Securities Exchange Act of 1934 with a view to establishing a special category of "Small Business Broker Dealer." These broker/dealers could specialize in small business securities and solicit investors.

NASDAQ should revisit its listing standards in order to avoid the delisting of companies which do not meet the new revised standards. The market capitalization or non-affiliated investor interest in a small company is drastically decreased by loss of listing.

A third tier of NASDAQ should be developed to cover securities issued under Rule 504 and Regulation A. This tier should be subject to surveillance and oversight just as the other levels of the NASDAQ market.

Investment Company Act

The SEC should exempt Small Business Investment Companies (SBICs), formed with less than $10,000,000 of capitalization, from the requirements of the Investment Company Act of 1940 to facilitate the formation of small SBICs which will allow them to have more than

100 shareholders and thus be able to be created and serve the needs of small businesses, especially in smaller and rural communities.

BDCs need to be made more competitive and able to better serve the needs of small business by (1) permitting them to acquire assets from third parties in private transactions, and (2) increasing the leverage capability of the BDC if it has sufficient income to service the leverage.

Federal/State Regulation

The SEC should facilitate and encourage the North American Securities Administrators Association, Inc. (NASAA) to: Continue working for uniformity of review of the SCOR and the adoption of SCOR by all states; Encourage the states to adopt a policy to recognize and agree amongst themselves that SCOR registration review in one state may satisfy the requirements of all states in which the form is filed and a lead state should be identified or identifiable to undertake the review and comment on the SCOR form for all states in which the form is filed; Establish SCOR regional field offices for the centralized filing, review and approval of SCOR filings. Additionally, if determined to be feasible and in the public interest, these regional field offices should have the ultimate goal of becoming privatized and self-sustaining.

The SEC and NASAA should reduce the per share minimum dollar amount for SCOR and the SEC cold-call rules from $5 to $3 per share.

The states should be preempted from registering securities offerings but not from enforcing their anti fraud rules.

The State securities regulations should be subject to review by the SEC in order to achieve uniformity and avoid adverse impact upon capital formation.

SCOR regulations should be altered to permit the advertising of SCOR stock beyond the present tombstone arrangement, so that a description of the company and the availability of the disclosure documents would be permitted.

Merit review should be eliminated.

The SEC and the state regulators should develop regulations defining small business and permitting an expansion of the test the waters provisions.

2. EDUCATION

In order to facilitate the availability of capital to the small business community, an information clearing house should be developed which offers and publicizes the existence of a data bank devoted to informing parties of available capital sources in amounts of less than $150,000.

When small business parties seek capital and utilize programs such as SCOR they should be referred to pro-bono professionals in their localities for assistance in properly completing the required forms. The SBA should maintain a current list of pro-bono professionals.

SBA offices should be equipped to provide a securities law outreach/education program to inform the business and financial community of the availability of SCOR and other similar securities registration/issuance avenues. Innovative means to finance such programs should be considered such as using monies received as fines for securities violations or filing fees.

Efficient information dissemination mediums should be developed which provide issuers with a comprehensive database of financial service intermediaries (e.g., broker/dealers, banks, audit companies, seed capital sources) that are active and interested in providing capital to small businesses.

3. BANKS

All loans for less than $250,000 (whether or not SBA guaranteed), made to small businesses, should qualify under the Community Reinvestment Act.

Banking practices should be modified: a. To encourage more independent small banks; b. To encourage character loans; c. To encourage uniform application of existing regulations; d. To permit the examination of small business loans as a pool in the manner in which consumer loans are now examined.

The Community Reinvestment Act should be applied on a state and community basis. Banks should be discouraged from investing in Treasury Bills and should instead make loans which might benefit the community including SBA guaranteed loans.

The four bank regulatory agencies should be asked to take into consideration the type of community and the type of bank in drafting standards for regulating banks and judging loan quality.

Loans need to be standardized for small business. This will facilitate the important liquidity option which comes from securitization.

4. SMALL BUSINESS ADMINISTRATION

The SBA should reaffirm its commitment to helping small businesses that otherwise can not meet the collateral requirements for traditional lending facilities by: 1. returning the SBA guarantee under the 7(a) program to the original levels of 90% for loans less than $155,000 and 85% for loans in excess of $155,000; 2. Establishing more realistic collateral requirements to eliminate the over collateralization that is now being required and thus eliminate the undue burdens on small business that such activity imposes, which is inconsistent with the legislative intent of the SBA loan program.

SBA loan pricing flexibility should be restored to preferred lenders (PLP's).

Eliminate the fee for banks selling off SBA loans in the secondary market.

Eliminate the prepayment penalty for paying off 503 loans.

The size standards under the SBA's 7(a) lending program for small business should be adjusted upward to more reasonably address the need of those businesses that require term financing yet is still small in comparison to other industry standards such as for SBICs.

All government lending and guarantee programs should be unitized so they can be operated in a closer, more cooperative spirit to serve the needs of small businesses.

The SBA loan program should be modified so that: a. Loans would not have to be asset based; b. The definition of small business would be consistent with that used by other agencies, both federal and state; c. More field personnel would be available so as to speed loan processing.

The Congress is urged to improve the secondary market for SBA loans, and facilitate a market for securitized small business loans.

The SBA Guarantee Program for loans under $25,000 should be made permanent.

The SBA should encourage banks making the smaller loans to join with the Small Business Development Companies to provide much needed management and technical assistance.

The premium split between the SBA and lenders on the sale of SBA guaranteed loans should be adjusted more equitably between long and shorter term loans so as not to penalize these lenders in making long term credits available to small businesses.

The restriction on the ability of an SBIC to borrow from outside sources should be increased from the current $10 million level.

The SBIC cap on borrowing from the SBA should be eliminated.

The pre-payment penalties on debentures sold by SBICs to the SBA should be eliminated.

5. TAXATION

The Tax Code should be amended to provide individuals with the same 85% dividend exclusion as is available to corporations for dividends received on small business stock held for 5 years or more, with an attendant deduction from income for the small business for the payment of such qualifying dividends. This modification should be available only for non-public companies (i. e., companies not, subject to the 34 Act) and also, with respect to the individual recipients, only for non-affiliated investors.

Tax and related laws should be revised to allow individuals to invest their own retirement funds (including IRAs) in their own small businesses, and to defer corporate income tax for firms which are using these funds in the operation of their businesses.

Internal Revenue Code section 108 should be changed to provide that forgiveness of small business debt does not give rise to income if the business is bankrupt or insolvent.

The capital gains provisions of the Budget Reconciliation Act passed on August 11, 1993, are inadequate and will not help much. People who invest in small business through market transactions, either in IPOs or in the secondary market do not invest for the long five year term. To encourage them to invest in small businesses a rollover of the tax consequence should be provided so long as the investment is in a business classified as a small business at the time of investment.

The Congress should further reduce the capital gains tax to 10% for small business investments. The holding period should be 3 years.

The capital gains differential should be on a sliding scale which relates to the time the asset has been held, with the rate reducing the longer the period held.

There should be a tax free roll over for the proceeds received by investors reselling securities initially acquired in small business initial public offerings as well as in the secondary market so long as those proceeds are reinvested in another small business or the securities of another small business.

The 30% withholding tax on equities held by foreign pension trusts should be eliminated in its entirety or at least to the extent invested in small businesses.

The permissible deduction for ordinary losses (currently limited to $1.5 million) should be increased.

The tax placed upon SBA government guaranteed lenders on the premium they receive in the secondary market sale of the government guaranteed portion of loans should be eliminated.

6. MISCELLANEOUS

The SBA and SEC should encourage, consistent with their respective charters, the Import Export Bank (Exlm) and the Overseas Private Investment Corporation (OPIC) to cooperate on the diversification of capital development facilities available to new and existing offshore enterprises in which small U. S. businesses are the majority owning sponsors.

Exlm and OPIC should afford increased opportunities for use by small business of various export finance facilities including, but not limited to, export trading companies under the 1983 Act.

The Federal Bankruptcy Code should be amended to simplify the process for both small business debtors and creditors.

II. INTRODUCTION

The U. S. Securities and Exchange Commission is required by law to host an annual forum which focuses on the capital formation concerns of small business. Thus, and in furtherance of the mandate of the Small Business Investment

Incentive Act of 1980, in each of the past twelve years, the SEC Government-Business Forum on Small Business Capital Formation has been convened. A major purpose of the Forum is to provide a platform for small business to highlight perceived unnecessary impediments to the capital-raising process. Numerous recommendations have been developed at these Forums seeking legislative and regulatory change in the areas of taxation, securities regulation, financial services and state and federal assistance. Participants at the Forum typically are small business owners, venture capitalists, government officials, trade association representatives, academicians and advocates of small business. While a number of different formats have been tried over the years, a very effective one for purposes of the development of recommendations for governmental action has included the use of small interactive participant groups; and in recent years, the Forum has typically included this feature.

The Twelfth Annual Forum was held in Washington, D. C. on September 9 and 10, 1993. The Forum is governed by an Executive Committee comprised of senior government officials and representatives of small business who have a strong interest and expertise with the issues and capital-raising problems of small business. The Executive Committee organizes, plans and implements the Forum.

For the 1993 Forum, the Executive Committee determined that the format of the sessions would begin each day with a panel discussion to address current small business issues as encountered by actual small business entrepreneurs and recent developments with respect to the offer and sale of small business securities under applicable law. The remainder of the sessions would be devoted to the small working groups comprised of the Forum participants with a view toward development of Forum recommendations for legislative and / or regulatory action.

The respective morning sessions proceeded with the scheduled panel discussions. The luncheon addresses were presented by Arthur Levitt, Chairman of the U. S. Securities and Exchange Commission, and Erskine Bowles, Administrator of the U. S. Small Business Administration, respectively. The afternoon break-out sessions produced many proposed recommendations for adoption by the Forum. Sixty-four recommendations were approved by the Forum participants and are highlighted in the following section of this report. Six proposed recommendations did not receive a plurality of favorable votes and thus do not constitute recommendations of the Twelfth Annual Forum. Those proposals were:

"The definition of "sophisticated investor" under Regulation D should be revised to include anyone who invests $50,000."

"Any required state or federal disclosure legend that offerings involving an investment in a small business could result in the complete loss of the investment should be eliminated."

"The SEC should provide a safe harbor from, or eliminate Section 12 liability for Broker/Dealers engaged in a SCOR offering, retaining liability of the B/D only for its own misconduct. That is, the B/D should have no responsibility or liability for the SCOR disclosure."

"Appraisal requirements should not apply for any loan made to a small business where the amount of the loan is under $2,000,000."

"SBA itself should be elevated to cabinet status."

"An independent office of small business advocate should be created, adequately funded and made a cabinet level position."

While the U.S. Securities and Exchange Commission hosts this annual convocation of small business friends and advocates, and is pleased to serve as such, it in no way seeks to sponsor or influence any of the Forum's recommendations. While a number of these matters are of substantial interest to the Commission as an institution, it takes no position on any of the recommendations. The views in this report are those of the Forum participants.

III. SECURITIES REGULATION

A. Statement of the Issues

Compliance with securities regulations may impose substantial costs upon issuers of securities. There is a geometric progression in the impact of such costs relative to the smallness of the issuer. Coordination of federal and state regulation continues to be needed and substantial relief from costs would flow from a more unified system of regulation.

B. Recommendations

Securities Act of 1933

Rule 147 should be amended to eliminate the requirement that the issuer be incorporated within the state where the offer is being made; that the residence of purchasers, not offerees, control the intrastate nature of the offering; reduce the 80% within the state use of proceeds requirement to permit, for example, the

purchase of equipment from a business located in another state; and introduce a good faith and substantial compliance standard.

Rule 147 provides, among other things, definitional guidance to the intrastate offering exemption provided in section 3(a)(11) of the Securities Act. This exemption is a very difficult one to sustain due to the necessity of maintaining the local character of the offering through both local offers as well as sales and the local nature of the issuer's business. The proposal would lend additional helpful guidance to issuers relying upon the exemption and also permit a defense against third party suits for inconsequential deviations from the terms of the exemption, a process that has been adopted in recent Commission rulemakings.

The SEC should use the authority under Section 3(b) to create a regional offering exemption (which would allow an intrastate type exemption for a region even though the region may cross state lines.)

Issuers that are geographically located in proximity to state lines should be permitted, due to the local natures of their businesses and the familiarity local citizens have with their businesses, the use of the intrastate exemption, even though investors may live on both sides of a state boundary line. This result is not possible under the terms of section 3(a)(11) of the Securities Act. However, it is a desirable result and would assist many local small businesses with their financings and could be accommodated pursuant to the Commission's "small issues" authority in section 3(b) of the Securities Act.

The SEC should develop a set of safe harbors to the provision prohibiting general solicitation as set forth in Regulation D. Example of Safe Harbor: The following shall not be considered as general solicitation: a. Pre existing relationship between offerer and offeree, b. Investment fairs or electronic bulletin boards, c. When you believe that a party mailed materials to would qualify as an accredited investor.

Offerings are limited under Regulation D through its prohibition on general solicitations and advertising. The Commission should provide more comprehensive guidance on the issue of when an issuer may be involved in a general solicitation and set "safe harbors" so that issuers may proceed in confidence that the claimed exemption will not be lost because of activities which involve a general solicitation.

Regulation D should be amended to permit solicitations up to 100 investors and the maximum number of unaccredited investors should be raised from 35 to 50.

Regulation D should permit without restriction offers to no more than 100 persons without triggering a general solicitation. Such a small number of potential

investors is sufficiently limited to stay in keeping with the limited nature of the transaction exempt under Regulation D. The number of unaccredited investors permitted to participate in offerings under either Rule 505 or 506 should be increased to 50.

Accredited investor status under Rule 501(a)(3), covering certain corporations and charitable organizations, should be attained with total assets in excess of $1,000,000 rather than $5,000,000.

More institutional accredited investors could be safely reached by simply lowering the asset test from 5 to 1 million dollars. This action would be beneficial to small businesses and have little impact upon the protection of investors because the types of investors would still be able to fend for themselves and get the protections registration delivers without further assistance.

Additional individual accredited investors should be defined but based on the ability of the investor to sustain the complete loss of the investment but not tied to the investors net worth or income levels.

Adding investors to the list of accrediteds based upon their ability to sustain a complete loss of investment makes sense and would make available more risk-based capital for small business investment.

The Rule 144 holding period for the sale of restricted securities should be reduced from 2 years to one year.

The selection of the 2-year holding period before restricted securities might be resold by investors was an arbitrary one by the Commission. A reduction in that period to one year would be beneficial to small business because there could be more potential investors interested in purchasing if they could see the future liquidity of their investment, because one year is a sufficient period to show investment intent and it is long enough so that there would not be an adverse impact upon investor protection.

The Commission should consider establishing minimum amounts of disclosure which, when made in an offering document, would create a safe harbor for the issuer, under Rule 504 for example.

Safe harbors provide the objectivity which small business needs to determine whether or not exemptions are available without incurring costly professional advice. By dictating that minimum level of appropriate disclosure for the smallest exemption, small business would get a greater utility out of the so-called "seed capital" exemption.

The SEC tombstone rule permitting certain abbreviated but protected written notices before and during the registration period should be reviewed. The advertisement should indicate what the company does.

A review by the Commission of the current tombstone rules which permit certain limited announcements of proposed offerings would be desirable. The result of that review could permit a wider application of the provision which would benefit small business. At a minimum, a more detailed description of the company's business should be permitted in the advertisement.

A Business Development Company (BDC) would be the ideal vehicle for investing in Small Corporate Offering Registration (SCOR) and Rule 504 stock except that there is no clear regulation on how to value these types of securities in their port folios. Therefore the SEC should formulate valuation guidelines for BDC portfolio stocks.

The Commission should establish objective guidelines which indicate the acceptable methods for valuing the securities of companies for which there exists no active trading markets. By doing so, more BDCs will be willing to invest in the securities of small companies and in particular those that have offered their securities under the SCOR program of disclosure.

The Financial Accounting Standards Board (FASB) rule to require companies to expense the value of stock options should not be adopted.

Small businesses will be especially hurt by this new accounting standard. Compensating employees with stock options and other securities based benefits is a popular way to reward the efforts of the company's workers without having to divert cash which is needed for the business. The accounting change will make the financial condition of the company appear worse than it is which will make investors less likely to participate in the business opportunity.

Legislation penalizing frivolous securities fraud lawsuits by raising standards of proof and shifting legal costs to unsuccessful litigants should be adopted.

The costs connected with the defense of a securities fraud lawsuit can be substantial and are particularly burdensome to a small business. When these claims are frivolous, the claiming parties should be penalized for their actions. The ease with which such frivolous lawsuits may be pursued also makes it appropriate that the standards of proof be raised to protect companies from abuse of process.

Damages in securities cases should be based on separate and proportionate liability. Proportional liability should be the rule as a means of limiting the risks of the professional advisor acting in good faith.

A corollary to frivolous lawsuits is the negative impact such a possibility has upon availability of and the reasonableness of the charges by professional advisers in connection with securities offerings. This situation has a particularly bad impact upon smaller businesses. If concepts of proportional liability, rather than joint and several responsibility, were introduced into the damages system, more professional advisers at a reasonable cost would be available to the small businesses seeking to offer their securities for sale.

Securities Exchange Act of 1934

The SEC should encourage and work with the National Association of Securities Dealers (NASD) and the Exchanges and coordinate those activities with the states to make it possible for every public company, especially service companies, to have their stock traded on an organized exchange or NASDAQ (NASD's Automated Quotation System), by, for example, developing standards other than asset base and net worth for listing.

The Exchanges and NASDAQ provide important services to both issuers and investors. The information stream is most effective in connection with issuers connected with Exchanges and NASDAQ. In addition, the resulting liquidity in the securities of these issuers benefits both the issuers and investors as well. The Commission should work to have all public companies participate in either a national securities exchange or the NASDAQ.

The NASD should publicly support and parallel the American Institute of Certified Public Accountants (AICPA) position that SEC Practice Section membership is the sole criteria for determining qualification of CPA's to perform SEC accounting work.

Inasmuch as the AICPA places weight upon membership in the SEC Practice Section in terms of the education and knowledge which can be derived from such affiliation, other organizations also should acknowledge the value and benefits which flow from such membership.

The Commission should review the requirements of the Securities Exchange Act of 1934 with a view to establishing a special category of "Small Business Broker Dealer." These broker/dealers could specialize in small business securities and solicit investors.

A special category with special requirements and benefits should be introduced into the Commission's system of registering and regulating broker/dealers. By establishing an experience level for these broker/dealers who would specialize in the securities of small businesses, certain accommodations could be made in the regulatory system to the benefit of both the broker/dealers as well as the investing public.

NASDAQ should revisit its listing standards in order to avoid the delisting of companies which do not meet the new revised standards. The market capitalization or non-affiliated investor interest in a small company is drastically decreased by loss of listing.

When NASDAQ increases its entry and maintenance standards, more generous grandfathering provisions should be made to accommodate those issuers already participating in the market so that they and their shareholders are not disadvantaged by the change in requirements.

A third tier of NASDAQ should be developed to cover securities issued under Rule 504 and Regulation A. This tier should be subject to surveillance and oversight just as the other levels of the NASDAQ market.

Liquidity in the securities of small businesses is essential to the viability of using securities sales as a method of small business financing. A special market within NASDAQ dedicated to these issuers would be of tremendous value to small business and provide significant safeguards to the investing public.

Investment Company Act

The SEC should exempt Small Business Investment Companies (SBICs), formed with less than $10,000,000 of capitalization, from the requirements of the Investment Company Act of 1940 to facilitate the formation of small SBICs which will allow them to have more than 100 shareholders and thus be able to be created and serve the needs of small businesses, especially in smaller and rural communities.

The smallest of the SBICs should be exempted from both the registration requirements of the Securities Act as well as the regulatory requirements of the Investment Company Act. It is noted that these companies are subject to licensing and regulation by the Small Business Administration. The elimination of the duplication in oversight would work substantial benefits to the regulated entity and also provide additional sources of needed capital for small business.

BDCs need to be made more competitive and able to better serve the needs of small business by (1) permitting them to acquire assets from third parties in

private transactions, and (2) increasing the leverage capability of the BDC if it has sufficient income to service the leverage.

The Commission's BDC program would be more effective and better served by relieving these companies from regulatory requirements of this nature. The benefits that would come from more sources of venturecapital for small business would far outweigh any risks to the investors in these entities.

Federal/State Regulation

The SEC should facilitate and encourage the North American Securities Administrators Association, Inc. (NASAA) to: Continue working for uniformity of review of the SCOR and the adoption of SCOR by all states; Encourage the states to adopt a policy to recognize and agree amongst themselves that SCOR registration review in one state may satisfy the requirements of all states in which the form is filed and a lead state should be identified or identifiable to undertake the review and comment on the SCOR form for all states in which the form is filed; Establish SCOR regional field offices for the centralized filing, review and approval of SCOR filings. Additionally, if determined to be feasible and in the public interest, these regional field offices should have the ultimate goal of becoming privatized and self-sustaining.

The goal of uniformity between federal and state regulation of securities matters would be greatly enhanced if the system offered greater uniformity of regulation between a number of states. The Federal system has essentially deferred to state regulation with respect to the small offerings subject to Rule 504 of Regulation D. This situation offers the states the opportunity to unify their regulation of these small offerings by getting together and designating a lead state for the review of and responsibility for offerings which touch one or more states.

The SEC and NASAA should reduce the per share minimum dollar amount for SCOR and the SEC cold-call rules from $5 to $3 per share.

The $5 levels for use of the SCOR form and the application of the Commission's cold-call rule (Rule 15g-9) were both selected before comprehensive federal/state enforcement efforts were undertaken and federal penny stock laws and rules were adopted. Several years have now passed and the abuses in the penny stock area have been significantly reduced and continue to be subject of serious federal/ state oversight. The proposed limited changes to $3 can be safely taken at this time because of the other provisions which are now in place.

The states should be preempted from registering securities offerings but not from enforcing their anti fraud rules.

The federal system of registering and exempting securities and transactions from registration is sufficient in the public interest and to protect investors; the state presence in this activity is duplicative and unnecessary. Significant savings, cost and otherwise, would result if the states did not register securities and transactions involving securities sales.

The State securities regulations should be subject to review by the SEC in order to achieve uniformity and avoid adverse impact upon capital formation.

An idea which has not been tried but would have the benefit of maintaining the states presence in the area of securities regulation but offers the potential of significant cost savings is to subject the regulations promulgated by the states to a uniformity review by the Commission.

SCOR regulations should be altered to permit the advertising of SCOR stock beyond the present tombstone arrangement, so that a description of the company and the availability of the disclosure documents would be permitted.

Marketing of the securities subject to the SCOR registration procedure should be made easier by permitting greater publicity of the offering without being accompanied by the offering circular.

Merit review should be eliminated.

State reviews which seek to determine which offerings are "fair, just and equitable" to the citizens of their jurisdictions should be abandoned in favor of a disclosure system which gives investors the opportunity to make up their own minds as to whether or not a particular investment is suitable for them.

The SEC and the state regulators should develop regulations defining small business and permitting an expansion of the test the waters provisions.

Federal and state regulation of securities should provide a separate system which applies to small business, a term which should be defined. This abbreviated system should seek a balance between the needs of the company for capital and the needs of investors for protections. Broader availability and use of the test the water system would be very helpful to small business.

IV. EDUCATION

A. Statement of the Issues

The small business entrepreneur spends most available time on the business. Government services and opportunities need to be more effectively brought to the attention of these business persons. Information in hand will lead to success in the business which in turn will help the economy.

B. Recommendations

In order to facilitate the availability of capital to the small business community, an information clearing house should be developed which offers and publicizes the existence of a data bank devoted to informing parties of available capital sources in amounts of less than $150,000.

Whether operated on a national or a local basis, a central repository of sources of available capital would provide a significant benefit to small businesses in need of funds.

When small business parties seek capital and utilize programs such as SCOR they should be referred to pro-bono professionals in their localities for assistance in properly completing the required forms. The SBA should maintain a current list of pro-bono professionals.

Costs of locating and retaining competent professional advisers for the sale of small business securities could be minimized by the maintenance of listings of persons willing to provide such services on a pro bono or discounted basis. The SBA could maintain this sort of information locally for small businesses.

SBA offices should be equipped to provide a securities law outreach/ education program to inform the business and financial community of the availability of SCOR and other similar securities registration/issuance avenues. Innovative means to finance such programs should be considered such as using monies received as fines for securities violations or filing fees.

SBA local offices are particularly well positioned to offer information of all kinds to the small business entrepreneur. By adding information about available simplified methods of selling securities under applicable law, small business would be better informed as to more available options.

Efficient information dissemination mediums should be developed which provide issuers with a comprehensive database of financial service intermediaries (e.g., broker I dealers, banks, audit companies, seed capital sources) that are active and interested in providing capital to small businesses.

All types of financing options and information about them should be available to small business. A centralized repository of this information would be a significant aid to companies in need of capital at various stages in their development.

V. BANKS

A. Statement of the Issues

A prime source for small business capital has always been the commercial lender. Unfortunately, too heavy of a dependence upon this source leads to problems when general economic conditions are not strong. Changes in the lending system would lead to a steady availability of commercial loans for small business and this would be a desirable situation.

B. Recommendations

All loans for less than $250,000 (whether or not SB A guaranteed), made to small businesses, should qualify under the Community Reinvestment Act.

Current restrictions for qualifying of loans under the favorable provisions of the community redevelopment statute should be reviewed with the design of permitting more loans to be made to small businesses which in turn will benefit the communities where such loans are made, a fundamental purpose of this remedial statute.

Banking practices should be modified: a. To encourage more independent small banks; b. To encourage character loans; c. To encourage uniform application of existing regulations; d. To permit the examination of small business loans as a pool in the manner in which consumer loans are now examined.

Small businesses suffer from the wave to create bigger banking organizations. Small local banks are more likely to understand local small businesses and be willing to take a chance on lending them funds. Regulators who are in a position to do so should influence banking practices to accommodate the needs of small business.

The Community Reinvestment Act should be applied on a state and community basis. Banks should be discouraged from investing in Treasury Bills and should instead make loans which might benefit the community including SBA guaranteed loans.

The inclination of some bankers to play it safe and invest available funds in government securities rather than in making loans to benefit local communities and small businesses should be actively discouraged.

The four bank regulatory agencies should be asked to take into consideration the type of community and the type of bank in drafting standards for regulating banks and judging loan quality.

The bank regulators could, and should be encouraged, through their reviewing activities, act to encourage banks to make certain types of loans which would benefit small businesses, and local communities.

Loans need to be standardized for small business. This will facilitate the important liquidity option which comes from securitization.

Securitization of mortgage and consumer loans has provided an important source of additional funding options for lenders. Small business loans have not, for the most part, been able to join in this desirable liquidity feature due to the lack of standardization in the terms of these loans. Standard formatting would go a long way in furtherance of the securitization option and should be encouraged among lenders.

VI. SMALL BUSINESS ADMINISTRATION

A. Statement of the Issues

The U. S. Small Business Administration provides financial and other assistance, as well as advocacy service for the nation's small businesses. This agency as conceived by Congress is an important instrument in furthering and assisting the nation's small companies, and recognizes the role which such businesses play in the success of our overall economic picture.

B. Recommendations

The SBA should reaffirm its commitment to helping small businesses that otherwise can not meet the collateral requirements for traditional lending facilities by: 1. returning the SBA guarantee under the 7(a) program to the original levels of 90% for loans less than $155,000 and 85% for loans in excess of $155,000; 2. Establishing more realistic collateral requirements to eliminate the over collateralization that is now being required and thus eliminate the undue burdens on small business that such activity imposes, which is inconsistent with the legislative intent of the SBA loan program.

The SBA loan program is the backbone of the available capital network for small businesses. Any and all revisions to those programs which would make it easier for small businesses to be considered for such loans and at the highest possible levels should be considered. It is understood that credit worthiness and other reasonable banking qualifications for loans need to be maintained.

SBA loan pricing flexibility should be restored to preferred lenders (PLP's).

High quality lending participants in the SBA loan program should not be locked into the lending guidelines established by the SBA but instead should be granted the flexibility to vary requirements based on their judgement with respect to the particular borrower involved.

Eliminate the fee for banks selling off SBA loans in the secondary market.

This type of penalty acts to discourage lenders from participating in the SBA lending programs. If small business is to have the full benefits of this capital source, these little side impediments need to be eliminated in order to get the full usefulness and availability of the programs into place.

Eliminate the prepayment penalty for paying off 503 loans.

Small business borrowers should be able to take full advantage of market activities which affect interest rates when the impact of those forces is to lower such rates. Eliminating prepayment penalties would provide an appropriate benefit to small business.

The size standards under the SBA's 7(a) lending program for small business should be adjusted upward to more reasonably address the need of those businesses that require term financing yet is still small in comparison to other industry standards such as for SBICs.

Greater flexibility in all facets of the SBA lending programs would make them provide greater benefits to small business. The changes suggested throughout this section highlight a number of features which could be simply undertaken if such flexibility were built into the program under the category of granting lenders greater discretion.

All government lending and guarantee programs should be unitized so they can be operated in a closer, more cooperative spirit to serve the needs of small businesses.

There are many government sources for loans and guarantees. It would be beneficial if such sources were catalogued in a single location for small businesses to get a better idea of available options. Perhaps more importantly, greater efficiency to these programs as well as for the government would result if all such programs were operated pursuant to the same terms and procedures.

The SBA loan program should be modified so that: a. Loans would not have to be asset based; b. The definition of small business would be consistent with that used by other agencies, both federal and state; c. More field personnel would be available so as to speed loan processing.

Logistical matters should be simplified which would lead to greater overall efficiency in the SBA lending programs. Coordination of terminology throughout all governmental systems would eliminate confusion and make all such programs operate at their optimal efficiency. This situation in turn would provide significant benefits to both small business and the taxpayers.

The Congress is urged to improve the secondary market for SBA loans, and facilitate a market for securitized small business loans.

Liquidity of small business loans will free up more capital for availability for more loans to not only small business but other loans as well. The suggested actions would be in furtherance of this goal.

The SBA Guarantee Program for loans under $25,000 should be made permanent.

The small loan program was very successful and should be adopted by the SBA on a permanent basis. Frequently, it is the need for a seemingly small amount of funds that can make the difference between continued viability and insolvency.

The SBA should encourage banks making the smaller loans to join with the Small Business Development Companies to provide much needed management and technical assistance.

It makes good lending sense to educate the borrower when a small business loan is made. The Small Business Development Centers are able to provide excellent assistance to the small entrepreneur. Encouraging the use of this important resource will work to the benefit of all of the parties involved.

The premium split between the SBA and lenders on the sale of SBA guaranteed loans should be adjusted more equitably between long and shorter term loans so as not to penalize these lenders in making long term credits available to small businesses.

This feature of the program is another which has the tendency to discourage participation in the program. It does not provide the necessary or desired help when features like this one are not subject to discretion or flexibility depending upon the particular situation.

The restriction on the ability of an SBIC to borrow from outside sources should be increased from the current $10 million level.

This restriction which is designed to protect the viability of the company should be revised to account for larger SBICs in the program. For the very largest of the SBICs, this limit artificially bars the effective operation of their business.

The SBIC cap on borrowing from the SBA should be eliminated.

For larger SBICs, this cap, while presently at $90 million is a serious barrier to the effective pursuit of their businesses and should be increased. Such action will have concomitant benefit for small business through the addition of available funds for their needs.

The pre-payment penalties on debentures sold by SBICs to the SB A should be eliminated.

Penalties which are driven by a reaction to market forces on interest rates are a serious disincentive to developing new and even keeping existing capital sources for small business.

VII. TAXATION

A. Statement of the Issues

Tax policy has a heavy impact upon smaller commercial enterprises. In some cases, costs of compliance with federal taxing authorities means the difference between success and failure. Tax law should always provide relief for the smallest of affected entities.

B. Recommendations

The Tax Code should be amended to provide individuals with the same 85% dividend exclusion as is available to corporations for dividends received on small business stock held for 5 years or more, with an attendant deduction from income for the small business for the payment of such qualifying dividends. This modification should be available only for non-public companies (i. e., companies

not subject to the 34 Act) and also, with respect to the individual recipients, only for non-affiliated investors.

The proposed limited expansion of the dividend exclusion for qualifying small business investments would provide additional capital opportunities to small business. It is believed that this in turn would cause the development of more small businesses and with them the benefits which an active, vigorous small business environment nationwide brings to the economy, including employment opportunities.

Tax and related laws should be revised to allow individuals to invest their own retirement funds (including IRAs) in their own small businesses, and to defer corporate income tax for firms which are using these funds in the operation of their businesses.

The investment of retirement funds in one's own small business encourages savings, expenditure of serious efforts to succeed in the business and community development. National tax policy should be designed to further these worthwhile goals.

Internal Revenue Code section 108 should be changed to provide that forgiveness of small business debt does not give rise to income if the business is bankrupt or insolvent.

The benefit derived from adoption of this proposal seems self-evident. A lender with a small business loan in default and forgiven should not be liable for tax on the uncollectible debt.

The capital gains provisions of the Budget Reconciliation Act passed on August 11, 1993 are inadequate and will not help much. People who invest in small business through market transactions, either in IPOs or in the secondary market do not invest for the long five year term. To encourage them to invest in small businesses a rollover of the tax consequence should be provided so long as the investment is in a business classified as a small business at the time of investment.

While the capital gains relief recently adopted is a good start, small businesses need broader tax relief in order to attract the capital essential for their viability. Permitting tacking of the holding period for purposes of the new provision would be a good addition to the provision.

The Congress should further reduce the capital gains tax to 10% for small business investments. The holding period should be 3 years.

Additional revisions in the terms of the capital gains tax are necessary. Many countries reward the risks attendant upon capital investment by offering lower rates or no tax upon the return from investment in businesses or their securities.

The capital gains differential should be on a sliding scale which relates to the time the asset has been held, with the rate reducing the longer the period held.

The sliding scale approach to capital gains rates has appeal since it roughly calibrates risk to the time the investment is held. Since it works a desirable change in the current system, it is believed that it would provide more opportunities for small businesses to reach needed capital sources.

There should be a tax free roll over for the proceeds received by investors reselling securities initially acquired in small business initial public offerings as well as in the secondary market so long as those proceeds are reinvested in another small business or the securities of another small business.

Permitting tax free exchanges of this nature limited to securities issued by qualifying small business securities adds another desirable feature to the investment which in turn creates additional opportunities for small business to raise much needed capital through its sales of such securities.

The 30% withholding tax on equities held by foreign pension trusts should be eliminated in its entirety or at least to the extent invested in small businesses.

This withholding tax creates another barrier to investment which has a negative effect upon potential capital sources for small business. Lowering the barrier would present more opportunities for capital raising by small businesses which should be encouraged through our national tax policy.

The permissible deduction for ordinary losses (currently limited to $1.5 million) should be increased.

Increasing the potential deducibility of losses for income tax purposes creates another positive feature for risk oriented investors which in turn creates a favorable situation for smaller businesses since they tend to involve greater investment risks.

The tax placed upon SBA government guaranteed lenders on the premium they receive in the secondary market sale of the government guaranteed portion of loans should be eliminated.

The tax as well as any reduction in the percentage of a loan subject to the SBA guarantee affects the willingness of lenders to participate in the SBA loan

program because it impacts the profitability of such transactions to the lender. This situation in turn reduces the available sources of capital to small business.

VIII. MISCELLANEOUS

Recommendations

The SBA and SEC should encourage, consistent with their respective charters, the Import Export Bank (Exlm) and the Overseas Private Investment Corporation (OPIC) to cooperate on the diversification of capital development facilities available to new and existing offshore enterprises in which small U. S. businesses are the majority owning sponsors.

Government sponsored programs and lending facilities should place small business at the forefront of their considerations so that in every case United States small businesses are able to share in the opportunities presented by such programs.

Exlm and OPIC should afford increased opportunities for use by small business of various export finance facilities including, but not limited to, export trading companies under the 1983 Act.

There are many opportunities for small business to participate in and add value to the programs offered by Exlm and OPIC. An affirmative action program in this regard would be beneficial to all.

The Federal Bankruptcy Code should be amended to simplify the process for both small business debtors and creditors.

The process for claiming bankruptcy protection should be simplified for small business parties whether they are making claims against a debtor or are seeking the protection for themselves.

If national health insurance is adopted, it must not be unduly expensive for small business.

Potential costs of a national health care system could be high. Small businesses should not be subject to a disproportionate share of the costs for such a system.