Leighton Conklin Lemov Jacobs and Buckley
Washington, D.C.

October 6,1981

Mr. George Fitzsimmons
Secretary
United States Securities and Exchange Commission
500 North Capitol Street
Washington, D.C. 20549

Re: File No. S7-891

Dear Mr. Fitzsimmons:

I am writing on behalf of the National Association of Small Business Investment Companies (the "Association"), a Washington-based trade association representing over 300 venture capital firms. The Association has long been a supporter of reduced regulatory burdens on small companies and worked actively for the passage of the Small Business Investment Incentive Act of 1980 ("1980 Act"). That Act encouraged, among other things, the promulgation of federal regulations which would, to the extent possible, contain small business exemptive provisions which hopefully would be adopted by a majority of the states.

The Association commends the Commission for proposing Regulation D and encourages its prompt adoption with only minor changes. The Association believes that the Commission has done a commendable job in not only utilizing but also in expanding the definition of "accredited investor." The Commission is also to be commended for applying the accredited investor concept to placements of securities above $5 million. The Association has long argued that accredited investors are able to fend for themselves and that the dollar limitation is irrelevant.

One of the major deficiencies in Regulation D is that it would not allow investment companies to raise capital pursuant to Rule 505 which would establish simplified procedures for raising capital in amounts not exceeding $5 million. Your Release No. 33-6339 (the "Release") cited the special exemption available under Regulation E (17 C.F.R. 230.601 et seq.) as an alternative provision for investment companies. One problem with Regulation E is that it is only available for offerings in amounts up to and including $500,000, a sum which is clearly inadequate in terms of today's venture capital investment markets. The Association, therefore, encourages the Commission to allow investment companies to raise capital under Rule 505. In the alternative, it would

be helpful to raise the Regulation E ceiling to $5 million, but only with certain revisions of that regulation.

Allowing Regulation E to be used for offerings not exceeding $5 million would be much less attractive than expanding Rule 505 to the use of investment companies without other major changes in Regulation E, primarily because most venture capital firms prefer to operate privately and therefore under as little regulation as possible. Regulation E, on the other hand, is intended to be used by firms making small public offerings and is only available to firms registered under the Investment Company Act of 1940. The Investment Company Act of 1940, of course, has been excessively burdensome for Small Business Investment Companies ("SBICs") attempting to operate with more than 100 shareholders. Furthermore, Regulation E is only available to licensed Small Business Investment Companies, and "two-tier" venture funds are not included. The two-tier format, however, is a popular way for venture firms to organize, with an unleveraged fund as the parent and an SBIC as a subsidiary.

A further problem arises in that Regulation E requires that the SBIC be "registered under the Investment Company Act of 1940" (17 C.F.R. 230.602(a)). Last year, the Association worked hard for passage of the 1980 Act. Under the 1980 Act, venture capital firms with more than 100 shareholders may receive less onerous and more appropriate regulatory treatment and, while they are subject to certain provisions of the 1940 Act structure, they are not "registered" under the 1940 Act. Hence, an amendment to Regulation E would be necessary in order to allow 1980 Act companies to use that provision.

Private Placement Grandfathering

Since many private placements are in the formation stage throughout the country at any given point in time, the Association believes the Commission should clearly state that persons conducting placements commenced before the date Regulation D becomes final would be allowed to continue relying upon whichever exemption to registration under the Securities Act of 1933 they had been using. This provision is only reasonable since it would unduly burden persons, in terms of both effort and cost, to require them to restructure their compliance. Additionally, business decisions may have been made in reliance upon provisions within the existing exemptions which may be different than Regulation D so that permitting a continuation of that reliance seems only fair in the Association's opinion.

Private Business Development Companies as Accredited Investors

Proposed Rule 501 includes private business development companies, defined in the 1980 Act, within the definition of "accredited investor." Proposed 17 C.F.R.

230.501(a)(2). The method used to define the private BDC, however, calls into question the "purpose test" which was a subject of controversy during the negotiations on the 1980 Act. In order to avoid entertaining that controversy under the Securities Act of 1933, the Association recommends defining the private BDC under proposed section 501(a)(2) by reference to Title H of the 1980 Act which defines the private BDC.

501(a)(2) suggested language:

"Any private business development company as defined in 202(a)(22) of the Investment Advisers Act of 1940;"

Small Exchange Act Reporting Companies Should be Able to Use Rule 504.

The theory of not allowing companies to use the Rule 504 small offering exemption once their shareholder base expands beyond a certain point is reasonable. A problem, however, arises when companies make offerings (sometimes prematurely) when the public market is receptive to new issues, but later such companies encounter downturns in the market. Many times, such market downturns are accompanied by business operations problems. On such occasions it may be necessary to raise capital at the absolute lowest cost. Hence, when the company is most in need of additional capital, it would be barred from using Rule 504 because it had a sufficient number of shareholders from a previous offering to trigger 1934 Act reporting. The Association suggests that a restriction be placed on the size of company that, although reporting under the 1934 Act, could still avail itself of Rule 504. The Association suggests that the Small Business Administration size standards be utilized so that any company which meets the definition of small under the SBA regulations could use Rule 504 even if it were reporting under the 1934 Act.

Combining S. 18 and Regulation A

The Association supports combining Regulation A and the S. 18 offering into one small offering provision. Small businesses and their attorneys, especially if located outside of major metropolitan areas and not specialized in securities law, find it frustrating to deal with mazes of regulations which address a common goal but approach that goal from different directions. For that reason, the Association feels that it makes much more sense to have one public offering registration provision which is specially designed to meet the needs of smaller companies. The Association not only supports incorporating Regulation A and S. 18 into one provision, but also strongly supports including non-corporate issuers. The Commission has suggested on page 17 of the Release that the S. 18 Form be expanded to incorporate non-corporate issues. The Association feels that

provision should be applied to the regulation which would survive the two existing provisions.

Definition of "Accredited Investor"

The Association commends the Commission for aggressively expanding the definition of accredited investor which the Association has supported since it first appeared in H.R. 3991, introduced by Congressman James T. Broyhill in 1979. The Association encourages the Commission to consider reducing the net worth provision to $400,000, which would make it consistent with the suitability requirement drafted by the North American Securities Administrators Association and referred to on pages 18 and 19 of the Release.

Under that proposed uniform provision, an investment "... is suitable for the purchaser upon the facts, if any, disclosed by such purchaser as to his other securities holdings and as to his financial situation and needs. ... [I]t may be presumed that if the investment does not exceed 25% of the investor's net worth, it is suitable." Under the Rule as proposed, a purchaser of $100,000 or more would be defined as accredited. For purchases of less than $100,000, then, the $400,000 net worth would guarantee that the purchase is no more than 25% of such investor's net worth, consistent with the state suitability guideline.

60% Test for Accredited Investor Purchases

The Association commends the Commission for proposing to eliminate the current provision which shifts the burden of providing information to the issuer if a non-accredited investor purchases in an offering, provided that 60% of the offering is purchased by accredited investors who have not purchased on better terms than the non-accredited investors. The National Venture Capital Association has previously submitted that non-accredited investors are often excluded in private financings due to the costs associated with the delivery of the disclosure documents. The experience of the National Association of Small Business Investment Companies supports their assertion, and we wholeheartedly endorse the 60% test.

"Tiered" Informational Requirements

The Association supports the concept of tiering information requirements so as to make the information required consistent among the rules for dollar offerings of similar sizes. This type of approach is one which the Association has supported for years. The Association believes that the tiered approach will also work to make the regulations more useable by small business managers and attorneys not specializing in securities law.

Filing of Notice of Sales

The Association supports the concept of notices because they help the Commission gather important data for studying the utilization of exemptive provisions. This type of data gathering can help the Commission better design regulations which will help small issuers. The Association wishes, on the other hand, to caution the Commission on the type of data it requires from small private issuers since data which contains proprietary information, e.g., sales, profits, etc., can be used to the detriment of the small company if obtained by competitors. Also, the quantity of information should be limited so as not to burden the small issuer excessively.

Raising the Rule 240 Ceiling from $100,000 to $500,000 in Rule 504

The Release states on page 46 that the witnesses at the small business hearings consistently testified that the Rule 240 limit of $100,000 was insufficient to be of use to even the smallest businesses. The Association wholeheartedly agrees and supports raising that ceiling under Rule 504 to $500,000. The provision will be much more useful since the existing rule is de minimus.

Elimination of the Economic Risk Test Under Rule 146

As stated on page 55 of the Release, "[c]ommentators believed that where the purchaser is represented by person(s) meeting the sophistication standards, given information substantially equivalent to a registration statement and fully appraised of restrictions regarding resale, it is inappropriate to make a separate judgment concerning the investor's ability to bear economic loss." The Association commends the Commission for agreeing with those commentators, and we agree with the Commission that the protections preserved in proposed Rule 506 are adequate to protect investors and that as a result the economic risk test is not needed.

Again, the National Association of Small Business Investment Companies commends the Commission for this bold step forward in the small business area, and we encourage prompt adoption of Regulation D. We further hope that the states will hasten to adopt the regulation in substantially the form in which it has been proposed with consideration to the comments contained herein.

Very truly yours,

Leighton Conklin Lemov Jacobs and Buckley
Jeremiah S. Buckley