



**OPENING STATEMENT OF  
RICHARD C. BREEDEN, CHAIRMAN  
U.S. SECURITIES AND EXCHANGE COMMISSION**

**AT THE PUBLIC MEETING OF THE COMMISSION  
WASHINGTON, D.C.**

**JULY 29, 1992**

**U. S. Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549**

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Capital -- the money to start and expand a business -- is critical to any business, large or small. In recent years, small businesses appear to have confronted more and more difficulty in obtaining capital from their traditional sources, especially banks.

Small businesses are the very backbone of our economy. Firms with fewer than 500 employees employed more than 57 million Americans in 1990, and in the last few years small companies have created virtually all new jobs in the U.S. However, small businesses will not continue to be the driving engine of job creation, technological innovation and entrepreneurial spirit without capital. America's disastrous anti-initiative tax code severely punishes those who take risks to create small businesses. Worse still, the tax system drives capital away from equity investing in high-risk start-up ventures.

The rules the Commission will consider today are designed to reduce the cost of raising capital for small businesses. Our current system works very well for larger firms. In the last 18 months, 1,356 firms have made common stock offerings totalling

\$121.9 billion. However, that system is unnecessarily cumbersome, restrictive and costly for the smallest companies.

Offerings on a Form S-1 in 1991 involved average expenses of \$617,000. Of that amount, an average of \$300,000 went to legal and accounting fees. By contrast, legal and accounting fees for an S-18 were only \$113,000, and total expenses averaged \$208,000.

Though each offering on S-18 saved small businesses an average \$187,000 in professional fees, only 22 out of 121 offerings by small businesses could use that form because of the many conditions placed on its use.

Savings through use of Regulation A would have been even greater. There the average total expense in 1991 was only \$31,000. Sadly, the limitations on total offering amounts resulted in Regulation A being used in only 43 offerings out of nearly 2,400 registration statements filed in 1991. That is only 10% of the number of offerings using Regulation A only a decade ago.

Let me stress that the Commission shares the concern of some commenters about preventing fraud in the marketplace. However, it should be clear that the prevention of fraud does not mean that the marketplace should be eliminated for honest, law-abiding participants. Some take the position that, since small business investment can be risky and, like any investment, can be used by

dishonest people to perpetrate fraud, small businesses should simply be excluded from the market for capital. This result not only hampers legitimate business needs, it also deprives investors of the opportunity to get into a new enterprise and potentially sound investment on the ground floor.

It is a mistake to create a legal and regulatory system that seeks to target the process of raising capital with arbitrary investment formulae set by the government, rather than targeting those who defraud investors. It is a mistake to lose sight of the need for regulations that protect investors without stifling innovation. The Commission has carefully structured its Small Business Initiatives to foster capital formation while maintaining sufficient regulatory safeguards to protect investors. The Small Business Initiatives are firmly grounded in the Commission's 60-year-old system of demanding accurate and adequate disclosure, rather than the "merit" regulation that substitutes a state government's investment decisions that of an investor.

Two of the most innovative proposals that the Commission will consider adopting today are changes to the "seed capital" rule (Rule 504) and the proposed "testing the waters" provision under Regulation A. Under Rule 504, non-reporting companies will be able to sell up to \$1 million in a 12-month period without registration. However, Rule 504 will not be available for "blank check" offerings, due to the higher risks to investors of such offerings.

Seed capital offerings under Rule 504 will be permitted to use general investor solicitation, and securities sold under the Rule would no longer be required to be restricted securities. By making these securities more saleable by investors, investors should be more willing to purchase these securities. Unless an "exit" is available, fewer people will choose to enter an investment.

Under the "testing-the-waters" proposal, a small business conducting an offering under Regulation A would be able to ascertain whether or not potential investors are interested enough in the company to buy its securities before the company has paid professionals thousands of dollars to put together offering documents. Thus, this new approach is designed to solve an important practical problem faced by nearly every small company that faces the need for capital but doesn't yet have an active trading market for its stock. In testing the waters, the issuer cannot solicit or accept money until it has filed and qualified a Regulation A offering circular with the Commission. In addition, a copy of any written material used to test the waters must be submitted to the Commission.

Finally, adoption of these proposals today will create a single, simple disclosure system for small businesses. An entirely new offering form has been designed expressly for use by small businesses. This new form is designed to provide good disclosure, but to simplify the complexity of current requirements. Along with

the new small business offering form, there will also be a new integrated disclosure system for small businesses. New forms 10-KSB and 10-QSB have disclosure requirements conveniently contained in one easy-to-reference regulation, and they are designed expressly for smaller companies.

These proposals will aid investors and they will aid our economy. They won't end capital problems for small businesses, but they will help in an important way. Hopefully, other steps by the Commission and Congress will continue to focus on expanding capital for this critical sector of our economy.

## COMMENT LETTERS REGARDING SMALL BUSINESS INITIATIVE

On March 11, 1992, the Securities and Exchange Commission proposed its Small Business Initiative. The goal of the Initiative is to encourage the ability of small businesses and entrepreneurs to raise capital in the securities markets, a source of capital that has been of limited use to small businesses because of cost and regulatory complexity.

The Initiative would, among other things, amend regulations regarding the offering of securities by small businesses under the Securities Act of 1933 and the offering of securities by small business investment companies and business development corporations under the Investment Company Act of 1940. Periodic reporting requirements for small businesses would be streamlined and tailored to meet their needs. The Initiative also encompasses legislative proposals to amend the federal securities laws to decrease regulatory costs in connection with capital raising.

The Commission received a total of 66 letters commenting on the Small Business Initiative. As indicated by the following quotations, the letters almost unanimously express support for the SEC's action. Many of the letters make well-considered and helpful comments to refine the proposals.

\* \* \*

I support these changes . . . . The strength of our economy depends on new ventures and small businesses. . . . These [SEC] changes would dramatically facilitate not only our economic strength and job creation, but . . . [also] our quality of life.

David Eller

Former Co-Chair, Northern Calif. Venture Capital Ass'n

June 14, 1992

This letter is a voice from the "trenches", speaking out to applaud [Chairman Breeden] and the Commission on the proposed changes for Regulation D, Rule 504. . . . I recognized immediately the importance of the proposed changes, and I am encouraged to see that you and your agency have the wisdom to take this leadership role.

Richard J. Lee

Menlo Park, California

June 11, 1992

I am writing from the perspective of an entrepreneur who has gone through the struggle of trying to raise start up capital to launch a new business. . . . Thank you for having the vision to propose the changes to Rule 504.

James V. Rohde, Chairman and CEO

American Telecorp, Inc.

Redwood Shores, California

June 11, 1992

The [proposed change to Regulation D] makes eminent good sense for small entrepreneurs like us and we commend the SEC for initiating it.

Joseph I. Hall, General Partner  
Ideograph Associates  
Palo Alto, California  
June 2, 1992

I read the encouraging news that the SEC is moving to a simpler regulation of small business. This is a good move.

Richard V. Wyman, President  
Intermountain Exploration Co.  
Boulder City, Nevada  
March 17, 1992

I am delighted to read of the proposed enhancements via the proposed rule making for Regulation A. This is a major improvement for small, start-up businesses and I hope you are in receipt of many favorable comments.

Michael I. Keller, President  
Michael I. Keller Enterprises, Ltd.  
Alexandria, Virginia  
June 17, 1992

As a small businessman, I generally support SEC's Small Business Initiatives . . . . Revisions to Rule 504 and Regulation A will go a long way to aiding American entrepreneurs in capital formation efforts.

Patrick M. Clawson, President  
Metrowest Broadcasting Corp.  
Washington, D.C.  
June 18, 1992

As a life-long entrepreneur . . . . I fully appreciate the difficulties in raising capital for small emerging businesses. These changes most certainly would provide the impetus to encourage more entrepreneurial activity and ultimately create more jobs so sorely needed to speed the slow recovery of the U.S. economy. I thank you for your courage and foresight to propose these changes

Robert E. Lorenzini, President  
SunPower Corp.  
Sunnyvale, Calif.  
June 16, 1992

I'm writing this letter to applaud you and the commission for your wisdom, courage, and insight for unanimously approving the changes concerning the small offering exemption of Regulation D, Rule 504.

Mary Hubbard, President  
UniCube USA Inc.  
Oakland, Calif.  
June 18, 1992



We support the Commission's efforts to reduce, to the extent consistent with investor protection, both the compliance burdens that the federal securities laws place on small business issuers when accessing the public capital markets and the costs that such issuers must incur to prepare mandated disclosure documents and financial statements.

Deloitte & Touche  
Wilton, Connecticut  
June 18, 1992

We generally support the thrust of the Commission's efforts to facilitate capital raising by smaller businesses and ease the present disclosure burdens placed on such companies if they wish to raise capital under federal securities laws.

Price Waterhouse  
New York, New York  
June 17, 1992

As Chairman of the AICPA's Task Force responding to the Small Business Initiatives, I support all of its recommendations.

Edward W. O'Connell  
Wiss & Co. CPAs  
Livingston, New Jersey  
June 17, 1992

We're pleased that the Commission is seeking to change the regulations for small businesses in a manner that may help small businesses raise capital.

David Gladstone, President  
Allied Capital Advisers, Inc.  
Washington, D.C.  
April 27, 1992

I support the proposed changes to Regulation D, Rule 504. . . . I continually see the need for providing increased opportunities to gain access to seed capital. Our economic survival depends on encouraging successful enterprise.

Gabrielle Leonhard, President  
The Corporate Incubator  
San Francisco, California  
June 10, 1992

The Small Business Initiatives are a significant step by the Commission to improve the legal context in which small or developing companies in the United States seek and acquire capital.

Arter & Hadden  
Washington, D.C.  
June 17, 1992

In response to the Commission's Small Business Initiative . . . , [we] sent a summary analysis of the Initiative to approximately 1,300 enterprises with annual sales believed to be less than \$25 million . . . soliciting comment on the Initiative and its anticipated effects on small businesses. . . . [We] wish to state

our general support for the Initiative. Based on our clients' experiences, we believe that the lack of available bank financing, particularly in the Delaware Valley region, has adversely affected small businesses.

Clark, Ladner, Fortenbaugh & Young  
Philadelphia, Pennsylvania  
June 17, 1992

I applaud the expansion of exemptions contemplated by the small business initiatives . . . . The revisions to Rule 504 and Regulation A will certainly help to clear the regulatory underbrush for start-up companies and small businesses.

Stephen A. Marcus  
Holleb & Coff  
Chicago, Illinois  
April 3, 1992

I congratulate the Commission for its efforts to establish a favorable legal environment in which small business can participate in the public securities market.

Law Offices of Guy B. Maseritz  
Columbia, Maryland  
May 22, 1992

We commend the intention of the Commission to pursue the goals that have occasioned this initiative.

Robert B. Adams, Sr Vice President and Asst General Counsel  
The Chase Manhattan Bank, N.A.  
New York, New York  
June 18, 1992

In proposing these small business initiatives, the Commission has recognized that the federal securities laws can create very significant costs for start-up and small business companies seeking to raise capital. . . . The proposals would, among other things, streamline and expand the availability of Commission exemptions from registration under the Securities Act of 1933 . . . . The ABA shares the Commission's concerns regarding burdensome and unnecessary regulation. Seeking a reduction in regulatory burdens is of highest priority to our members.

Sarah A. Miller, Sr. Government Relations Counsel  
American Bankers Association  
Washington, D.C.  
June 22, 1992

The American Electronics Association (AEA) favors the agency's recent proposal . . . . I applaud the Commission's efforts to restore a simplified method for some small companies to raise capital in this difficult and costly capital market.

J. Richard Iverson, President and CEO  
American Electronics Association  
Santa Clara, California  
June 19, 1992

We have reviewed the proposals primarily from the standpoint of financial accounting and reporting matters. From that perspective, we agree with the general thrust of the proposals and support the Commission's efforts to simplify disclosure requirements for small businesses, especially for initial public offerings (IPO's) and offerings exempt from registration.

Barry W. Huff, Chairman, AICPA SEC Regulations Committee  
American Institute of Certified Public Accountants  
Washington, D.C.  
June 18, 1992

[The proposed revisions to Regulation A] seem likely to reduce capital costs for small businesses and thereby enhance competition and the efficiency of capital markets. . . . The SEC's proposals to revise Rule 504 . . . are also likely to reduce the cost of capital for small firms.

Comment of the Staff of the Bureau of Economics  
Federal Trade Commission  
June 19, 1992

AIMR and its component organizations have consistently supported new or revised regulations that stimulate capital formation, a key element of maintaining a healthy U.S. economy and the competitive viability of American businesses, both large and small. We also have been stalwart champions of the American investor . . . . After careful review, we believe that the proposed revisions generally strike an appropriate balance between these two laudable goals.

John L. Maginn, CFA, Co-Chairman, Steering Committee  
Anthony T. Cope, CFA, Co-Chairman, Steering Committee  
Association for Investment Management and Research  
June 12, 1992

We have written to Chairman Breeden on two separate occasions in the recent past applauding his interest in the capital raising problems of small companies, and we are generally supportive of the proposals contained in the Release.

John F. Guion, President  
Association of Publicly Traded Companies  
Washington, D.C.  
June 19, 1992

IBAT applauds the Securities and Exchange Commission for developing creative approaches in addressing a current problem of great economic significance to our nation.

Christopher L. Williston, President & CEO  
Independent Bankers Association of Texas  
Austin, Texas  
June 17, 1992

NAB applauds the Commission's efforts to ensure that small and new businesses will be able to raise the capital for expansion through the equity markets without having to undertake expensive regulatory compliance efforts which may reduce the potential value of the offering to a level which prevents the company from seeking new

## SMALL BUSINESS INITIATIVES

### ACTIONS OF THE SECURITIES AND EXCHANGE COMMISSION 29 JULY 1992 FACT SHEET

The Commission has formulated its Small Business Initiatives to achieve the following goals:

- To increase the ability of small businesses to raise capital in securities markets
- To simplify the process through which small businesses offer securities and reduce unnecessary costs of complying with the federal securities laws
- To facilitate growth of small businesses in a manner fully consistent with the protection of investors.

#### RULES ADOPTED

With some amendments, the Commission today adopted the rules it proposed for public comment on March 11. The proposed rules were enthusiastically received by small business commenters as steps to facilitate access to the securities markets and to reduce costs for start-up and developing companies.

#### 1. Rule 504

Rule 504 is the limited offering exemption for seed capital. Offerings of up to \$1 million in a 12-month period by companies that are not reporting companies under the Securities Exchange Act of 1934 are eligible for Rule 504. Although Rule 504 does not restrict the kind or number of investors, until today's action the rule did not allow, except where the securities were registered with a state, general advertising or other general offering activity. In addition, investors were unable to sell Rule 504 securities freely, which significantly reduced investor interest in acquiring such restricted securities.

The rules adopted today:

- Exclude blank check offerings from the expansion of Rule 504. (The Commission has proposed to exclude them entirely from offering securities under Rule 504.)
- Allow unconditional use of the \$1 million Rule 504 exemption for all other companies. (Before today's action, state registration was required to offer between \$500,000 and \$1 million under Rule 504.)
- Allow general solicitation of investors.
- Provide for free transferability of securities acquired under Rule 504.

These changes to Rule 504 should provide much-needed flexibility for small and emerging businesses to meet their capital needs. Of course, these offerings are still subject to the antifraud provisions of the federal securities laws.

## 2. Regulation A

Regulation A is an exemption from the registration requirements which allows a U.S. or Canadian company (except for blank check companies) to raise a limited amount of money by filing with the Commission and delivering to investors a simplified disclosure document. The company does not become obligated automatically to file annual and periodic reports with the Commission. Until today's action, Regulation A offerings were limited to offerings of up to \$1.5 million annually. As adopted, Regulation A offerings may be made up to the full \$5 million authorized under the Securities Act of 1933. The Commission already has asked Congress to increase the statutory limit to \$10 million.

The rules include a new provision that would allow companies to "test the waters" before filing an offering document under Regulation A. This provision allows a company without an established market for its securities to publish factual information about itself and its business, and to assess investors' interest in the company before it incurs legal, accounting and other costs in preparing a Regulation-A offering document.

The test-the-water provisions adopted today require that:

- Written materials used to test the waters contain (i) a statement that no money is being solicited or will be accepted and that no sales can be made until delivery of an offering circular declared qualified by the Commission and (ii) a brief, general identification of the company's business, products and CEO.
- Issuers submit to the Commission copies of written materials used to test the waters when the materials are first used.

These changes to Regulation A should help small businesses that seek public investment better to gauge the potential market for their securities. Consequently, if such a small business determines by testing the waters that there will not be sufficient investor interest in an offering of its securities, it may be able to avoid spending thousands of dollars in professional fees and other expenses in connection with preparing for an offering.

## 3. Small Business Integrated Disclosure System

The March proposed rules contained a new set of forms for small businesses to use to register securities and to file their

annual, quarterly and other periodic reports. Narrative disclosure for registration statements and periodic reports are contained in Regulation S-B, modelled after the streamlined disclosure requirements of Form S-18, which was used for small initial public offerings.

Under the new system, old Form S-18 is eliminated and replaced with a new small business securities registration form, named Form SB-2. Simplified forms for periodic reporting, such as Forms 10-QSB and 10-KSB, have been adopted substantially as proposed.

The small business integrated disclosure system adopted today is available for companies qualifying as small businesses. Small business issuers are those U.S. and Canadian companies that have annual revenues of less than \$25 million, and whose public float (voting securities held by non-affiliates) is not \$25 million or more. As originally proposed in March, small businesses would have included only U.S. companies with annual revenues of less than \$15 million.

These changes streamlining registration and reporting requirements will help small business issuers to invest funds in their businesses that otherwise would have been spent in compliance costs.

#### RULES PROPOSED FOR COMMENT

In addition to adopting its March proposals, the Commission released for comment today several proposals to facilitate small business capital raising and reduce reporting costs for small businesses. The proposals are based on the favorable reception for the Commission's adoption of a question-and-answer format for Regulation A filings and on commenters' suggestions for additional regulatory simplification for small businesses.

The new proposals would:

- Establish a transitional system for small businesses first entering the reporting system, under which they can continue to use the simplified question-and-answer format now permitted under Regulation A for offerings of up to \$5 million per year, while providing for the use of audited financial statements.
- Permit small-business initial public offerings of profitable enterprises to proceed during the latter part of their first fiscal quarter without waiting for completion of the prior year's audit.
- Automatically waive financial statement requirements for small acquisitions by small business issuers.
- Allow Regulation D private offerings by non-reporting companies to proceed without audited financial statements, where they are not otherwise available.