Remarks Of

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"Backtrack and Continue Small Business Initiative"

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*/ The views expressed herein are those of Commissioner Roberts and do not necessarily represent those of the Commission, other Commissioners, or the staff of the Commission.

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"Backtrack and Continue Small Business Initiative"

I appreciate the opportunity to participate in this Regional Investment Broker's program. It is my intention today to convey some of my thoughts on the problem posed by the multiplicity of securities regulatory schemes and on the continuing Commission effort to improve the efficiency of our small company capital formation system. To some extent, the two subjects do dovetail together.

I. Multiplicity of Securities Regulatory Schemes

I believe that the multiplicity of regulatory schemes encountered by securities industry participants is a problem both domestically and internationally for our securities marketplace. While I support the concept of an overhaul of financial services regulation as recently advocated by Jack Sandner of the Merc, I suspect that a congressional consensus for such an overhaul will not be forthcoming in the near future. In any event, the multiplicity of federal regulatory schemes is not all of the problem. The existence of dual state/federal securities regulatory schemes is also part of the problem, potentially the most significant aspect of that problem.

In a perfect world, it would be nice to have a non-overlapping state/federal securities regulatory scheme in place. In some states, like Florida, it is my understanding that there already is in place such a division of responsibilities. However, I further understand that such a circumstance is more the exception than the rule. Certainly the U.S. securities

regulatory world is far from perfect and will not become perfect in the near future. While the Commission has little control over most of these imperfections, I believe that it could do more.

Even though the Commission has made great strides to minimize the state/federal regulatory duplicity present in filing requirements for broker-dealers, investment advisers, and investment companies with the one-stop filing concept, it could do more and should intensify its efforts in this area. Further, the Commission did not take advantage of a golden opportunity in this area that was presented last year by the Commission's small business initiative.

As you may recall, the Commission adopted rules last year to improve the efficiency of the small company capital formation system but did so in a hasty, politically motivated manner. Yet, the rules adopted appear to be sound, at least in substance. In particular, I believe that the ability to "test the waters" by public solicitation of non-banking indications of interest in advance of filing Regulation A offering material is a significant innovative improvement. Unfortunately, for a Commission initiative designed to reduce burdens on capital formation to have much impact, the Commission must be able either to preempt contrary state rules or to persuade the states to tailor their rules accordingly.

Now the Commission has little in the way of state pre-emptive power. Further, by adopting new small business rules while moving at warp speed, the Commission neglected to make much

of an effort to cooperate with state securities regulators and to achieve the state/federal acceptance the rule changes need in order to have a significant impact. For example, the ability to "test the waters" under Regulation A requires similar state action to be significant. Fortunately, I understand that the North American Securities Administrators Association ("NASAA") now has a "test the waters" project under consideration. For another example, one change that was potentially among the most significant was the complete federal deregulation, except for the continued application of the antifraud provisions, of offerings by non-reporting issuers of up to $1 million under Rule 504. This change also becomes much more meaningful when accompanied by conforming changes to state law. Given time and encouragement, I believe that both of these changes would have been accepted by the states and still may be.

As Professor Sargent, in a Business Law Today article last year entitled "No More Tinkering! Let's Scrap the SEC's Rube Goldberg Contraption for Small Business Offerings," stated:

> No reform of federal securities regulation will work unless the state securities regulators have signed on, both in principle and in detail. The state regulator's sovereign ability to superimpose upon offerings in their jurisdictions additional, inconsistent or even prohibiting criteria means that they indeed have the last word, and that they can reduce the best-intentioned federal reforms to practical insignificance.

I do not know for certain that with more of an effort, the Commission could have achieved the cooperation of state securities' regulators to implement a simplified, less burdensome, unified state/federal small company capital formation regulatory scheme. However, such an effort should at least have been made. Thus, I am hopeful that the Commission in the near future will "change" its approach and will resurrect the notion of federal-state cooperation with a view to improving the efficiency of the small business capital formation process in a unified fashion without undermining fundamental investor protection safeguards. Of course it would have been much easier to achieve such harmony before the rule changes were adopted rather than after. Now a regulatory step backward may be required before forward steps can be taken. I do believe, though, that with encouragement, the states would harmonize their rules to conform with the Commission's small business rule changes. As matters presently stand, the Commission's small business initiative, while sound in substance, has not achieved much acceptance at the state regulatory level and therefore has minimal impact.

II. Continuing Small Business Initiative

Although the most important project for the Commission in the small business area is to approach the states and to attempt to gain as much acceptance as possible for the rule changes already adopted, there are additional actions that may be taken that could improve the efficiency of the small company capital

formation system. Of course on the investor side, tax incentives could be enacted. While this would be significant, such action lies outside of the jurisdiction of the Commission; and I merely wish to point out that the tax legislative avenue remains to be fully explored in the small business area in my opinion.

From a Commission standpoint, the additional pending small business proposals originated by the Division of Corporation Finance could be adopted after consultation with NASAA to ensure state acceptance and to avoid the muddle created by the first set of rule changes. While these proposals help only marginally, they are positive all the same. Further, after appropriate NASAA consultation, the Commission could consider the suggestion from an American Bar Association committee to amend Rule 147 and to create a meaningful local offering exemption based upon a combination of Sections 3(a)(11) and 3(b) of the Securities Act of 1933 for offerings up to $5 million. Moreover, assuming NASAA acceptance and no bad experiences under Regulation A, the Commission could extend the "test the waters" concept to make the concept available to small business issuers preceding some registered public offerings. I am sure that there also exist other rule changes that the Commission could consider and should consider in the small business area.

In addition to tax incentives, from a legislative standpoint, I support, with one exception, the bill recently introduced by Senator Chris Dodd of Connecticut, S. 479, the "Small Business Incentive Act of 1993." S. 479 is based largely

on legislation endorsed by the Commission last year and is intended to make it easier for small businesses to raise capital while maintaining important investor protections. I particularly support the provision in S. 479 modifying Section 3(b) of the Securities Act and increasing the authority of the Commission to exempt, from the registration provisions of the Securities Act, offerings up to $10 million. By enabling the Commission to extend the benefits of its exemptive rules to more financings, including small business financings, this provision, if enacted, should help increase the flow of capital to small businesses without creating inappropriate risks to investors.

However, I do not support the provisions of S. 479 which are designed to make it easier and less costly for so-called business development companies ("BDCs") to offer securities and to invest in small business. In 1992, there were only about 49 active BDCs; yet, according to information provided to me by the Commission's Division of Enforcement last year, about seven BDCs have been, or are expected to be in the near future, the subject of a Commission enforcement action. This is an extraordinary amount of enforcement activity for such a small universe. It strikes me as ludicrous to support an expansion of the ability of BDCs to operate in the face of such extensive enforcement experience. The notion that the legislative expansion of BDCs would be anything other than destructive to the small company capital formation system belittles the Commission's enforcement efforts in the BDC area and is sheer folly.

The last item in the small business area that I wish to mention today is securitization. As a part of its small business initiative last year, the Commission revised Form S-3 specifically to permit companies to register investment grade asset-backed securities without regard to their reporting history. Before the revisions, the benefits of Form S-3 and shelf-registration for delayed offerings generally were not available to issuers of non-mortgage related investment grade asset-backed securities. As a result, investment grade securities backed by small business loans or credit card receivables generally could not be registered for sale on a delayed basis and sold as market conditions warrant. The revisions to Form S-3 should reduce the costs of securitizing a variety of financial assets, including pools of small business loans, and hopefully will enhance significantly liquidity for lenders to small businesses.

The Commission also acted this past year to exempt structured finance vehicles from the Investment Company Act of 1940, thus freeing those innovative products to be a source of capital to small business, among others. Rule 3a-7 conditionally exempts structured financings from the Investment Company Act. The conditions of the rule seek to delineate the operational distinctions between registered investment companies and structured finance vehicles, to permit the continued evolution of the structured financed market, and to address investor protection concerns.

While it is too early to tell what effect these measures in the area of securitization will have, it is my understanding that securities backed by small business loans are expected to hit the market this month, the first time such assets have been securitized in a public offering. Freemont General, a California based insurance company, is apparently planning to issue $150-300 million of notes backed by small business loans in a revolving trust structure. Hopefully more such transactions will occur, and, accordingly, financial institutions will be able to make new, sound loans to more small businesses by being able to sell existing securitized loans more easily to third parties.

In conclusion, I anticipate that the Commission will continue to pursue a small business initiative, and I support and encourage such an effort. However, I hope that the Commission has learned from its experience to date. As Carl Schneider, in his recent article entitled "Small Business Capital -- the Need for Further SEC Initiatives," which appeared in Insights, stated:

> A well conceived program to aid small business should be coordinated fully with the states. This is an important step that the Commission neglected to follow in its 1992 Small Business Initiative.
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> I hope the SEC's actions to date will prove to be but the first step in an ongoing cooperative federal/state initiative to revise the system and reduce the burdens of capital raising for . . . small business . . . Such reform efforts should continue as a high priority item for the

Commission under the leadership of a new chairman.

I agree with those statements. It will be interesting to observe the Commission's direction in the small business area in the future.