

NEWS

**SECURITIES AND
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REMARKS BY

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Senate Committee on Small
Business
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I appreciate the opportunity to respond to Senator Weicker's request to spend a few minutes with you today to discuss the first SEC Government-Business Forum on Small Business Capital Formation and some developments since that time. I have with me today, Mary Beach, Associate Director of the Commission's Division of Corporation Finance, Paul A. Belvin, Chief, H. Steven Holtzman, Special Counsel, and Suzanne S. Brannan, Senior Staff Attorney, from the Office of Small Business Policy. They and other members of the staff were instrumental in planning the Forum and provided superb staff support.

The Forum was held pursuant to the Small Business Investment Incentive Act of 1980, which directs the Securities and Exchange Commission to conduct an annual government-business forum "to review the current status of problems and programs relating to small business capital formation." Congress also directed that other Federal agencies concerned with small business capital formation, such as the Department of Treasury, the Board of Governors of the Federal Reserve System, and the Small Business Administration, should participate in the Forum. In addition, the legislation requires that the Commission work closely with organizations representing state securities commissioners and leading small business and professional organizations concerned with capital formation.

The Forum recommendations contained in the final report reflect the majority views of the Forum participants

who met in Washington for the three-day period of September 23rd through September 25th, 1982, to develop and debate proposals designed to enhance the ability of small business to obtain capital. The Commission did not seek to influence the substance of the findings or recommendations. Moreover, as Chairman of the Forum, I requested that Federal government officials not participate in the voting on proposals which took place in the final Forum session.

Participants in the Forum were invited on the basis of their interest and expertise. Approximately 200 persons from throughout the nation attended the Forum, including many small businesspersons, accountants, attorneys, venture capitalists, bankers, broker-dealers, academicians, and government officials. In accordance with the Congressional guidelines, an Executive Committee of 21 representatives from private sector organizations and government agencies was assembled. The Executive Committee encouraged maximum participation by small businesspersons and invited all who indicated an interest in attending. In addition, members of the Executive Committee actively sought other prospects. These efforts resulted in about 30 percent of the participants being from small businesses.

The Forum's substance and procedures were guided by the Executive Committee, which established task forces to examine small business capital formation problems in four areas: (1) access to financial institutions, (2) raising capital, (3) taxation, and (4) credit availability. Although

its members were generally familiar with the problems confronting small business, the Executive Committee desired additional input concerning the most useful measures that could be undertaken to encourage capital formation. Accordingly, the Commission and the Financial Reporting Institute of the University of Southern California sponsored a survey to determine the views of small business executives. Based on the results of this survey and the guidance of the task force members, the SEC staff prepared eight issue papers which were sent to participants in advance of the Forum. These issue papers, which were designed to stimulate discussion and help participants focus their attention on specific problem areas, contained a number of proposals to encourage small business capital formation.

Most of the Forum was devoted to consideration of those proposals in working groups of fewer than 20 persons. On the final day of the Forum, the participants met in a plenary session to debate and vote on the final proposals. Many of the proposals in the issue papers and a number of additional proposals developed during the forum working sessions were approved. Some of the proposals would require only minor adjustments in the operation of existing programs or the implementation of current policies. Others are quite innovative and would require the approval of new financing tools for small business.

We have given you copies of the Final Forum Report, which includes information on all of the Forum recommendations.

The first eleven pages contain a summary of the recommendations. Twenty-two of the 37 Forum Recommendations would require legislative action in order to be implemented. At the request of Senator D'Amato, priority rankings for the legislative proposals were obtained by sending a questionnaire to Forum participants in December of last year. We have also provided copies of our letter to Senator D'Amato which includes a summary of the responses we received. Table 1 lists the 22 legislative recommendations. You will notice that 16 of them deal with changes in the Federal tax code. Table 2, which is on page 6 of the handout, lists the top ten legislative recommendations. I believe it is significant that nine of the ten are tax proposals. The tenth, number 19, would raise SBA's loan guarantee limits to \$1,000,000.

We all recognize that the recommendations made by the Forum are not an end in themselves. Instead, they represent a step in a long process. The ultimate goal is to implement the recommendations which have the most merit. Toward that goal, in addition to providing the Final Forum Report to members of Congress, we also sent copies to the presiding official of the various government agencies and departments and requested that they initiate an analysis of the proposals within their jurisdiction. I am pleased to report that the Securities and Exchange Commission has decided to set an example for other agencies by trying to act expeditiously.

Seven of the proposals approved by the Forum are within the Commission's regulatory jurisdiction and our staff

has completed a preliminary analysis of these recommendations. Based on this analysis, on February 25 of this year the Commission determined that at the present time two of the seven Forum proposals do not appear to be consistent with investor protection and full disclosure, which are the Commission's primary statutory mandates under the Securities Acts. At the February meeting the Commission decided that the other five proposals merit additional consideration and directed the staff to continue its work on those recommendations with a view toward rulemaking initiatives where appropriate. If, upon further analysis the Commission believes changes in our rules would be in the public interest, we will publish the proposed changes, and after considering comments from anyone wishing to respond, determine whether to implement them. A brief summary of the five proposals being actively considered may be of interest to you.

One recommendation is that the Commission permit small businesses whose securities are not actively traded to satisfy periodic reporting and proxy requirements by filing with the SEC and making available to security holders audited financial statements for the previous two years on an annual basis, and unaudited financial statements on a quarterly basis. The staff intends to study not only whether the cost of compliance with existing reporting requirements exceeds the benefits in the case of small businesses, but whether additional size criteria, such as total assets or net worth, should be required for triggering periodic reporting requirements in the first place.

Our staff is also studying a proposal that the Commission permit the use of Form S-18, a specialized abbreviated registration form for small issuers, for offerings of up to \$10 million, instead of the current \$5 million limit. One advantage of this form is that we permit it to be filed with our regional offices, rather than only here in Washington, D.C. This makes it easier for many registrants to obtain greater assistance from Commission personnel.

Another proposal is that a study be performed to determine whether financial statements of small business need to have all of the same information required of larger businesses in order to satisfy lenders and investors. This type of study is currently being conducted by the Financial Accounting Standards Board. Our staff has been, and will continue to, participate in these efforts.

A fourth recommendation being examined by the staff is that the Commission permit the resale of securities acquired in a non-public offering, known as "restricted securities," after a three year holding period, but without the current requirement that public information about the issuer be available prior to resale. Adoption of this proposal would enhance the liquidity and the desirability of acquiring restricted securities.

The final Forum recommendation being pursued by the Commission is the adoption by state legislatures of uniform limited offering exemptions that are the same as those implemented by the Commission on a federal level in Regulation

D last year. In developing Regulation D the Commission worked very closely with state securities administrators in an attempt to agree upon uniform exemptions. However, the state administrators, acting through the North American Securities Administrators Association, one year ago endorsed exemptions containing several important alternative provisions imposing additional conditions to those of Regulation D. Since that time, the Commission has continued to urge that the states adopt a single uniform limited offering exemption that is consistent with Regulation D. Our most recent meeting with representation from the States was held on the 21st of last month and I expect this effort to continue.

Other government agencies are also working on the Forum's recommendations. Just last week I received a letter from the Department of Labor in response to recommendations in the pension plan area. The Department indicated its basic agreement with several of the proposals and expressed an intent to take measures to implement them. I also understand that several items based on Forum recommendations are contained in draft legislation that the Small Business Administration plans to transmit to Congress. The specifics of that package are still being finalized, however, so at this time I am unable to provide any further details with respect to the provisions that it will contain.

The legislative process, which is the primary focus of this Advisory Council, is also underway. As one of their top legislative priorities, the Forum participants recommended

that Congress adopt a "Small Business Participating Security," which is a hybrid form of security that would offer both a fixed rate of interest and a percentage of profit to investors. Within the last month, a bill which would implement this Forum recommendation was introduced in the Senate with the bi-partisan sponsorship of eleven senators, including eight members of the Senate Committee on Small Business. While legislation to authorize such a security has been introduced in the past in both Houses of Congress, perhaps with the increased interest in small businesses, the efforts of this Congress will be more successful.

Furthermore, it is my understanding that tomorrow Senators D'Amato, Nunn and Weicker and Congressmen Nowak, McDade, Mitchell and Williams intend to sponsor identical bills in the Senate and House based on other recommendations made by the Forum. The Bills, entitled the "Small Business Capital Formation Tax Act," would make several changes designed to assist small businesses. Section 2 would reduce the corporate tax rate by increasing the surtax exemption from \$100,000 to \$200,000 and adjusting the brackets. Section 3 would provide an increase in the capital gains deduction to 80 percent for individuals selling a small business equity investment. To qualify, the investment must be held for at least five years before the gain is realized and then the gain must be rolled over into another small business investment. Section 4 would reduce from 28 to 20 percent the alternative tax rate which may be applied to net long term capital gains received by

corporations on investments in small businesses. Section 5 provides that a business may elect the cash method of accounting if the gross receipts from its principal business activity are less than \$1.5 million and it is an active participant in the management of the trade or business. Section 6 provides that a taxpayer who purchases stock in a qualified small business corporation is eligible to receive a 10 percent tax credit on the purchase price. Section 7 permits a deferral of capital gains on the sale of an asset when the proceeds are reinvested within 12 months in equity securities of a qualified small business corporation.

Because the Commission does not have any special expertise on tax matters, I do not believe it would be appropriate for me to comment on these proposals, except to say that I believe they would be of assistance to small businesses. The Treasury Department is the administrative institution that has the responsibility to make judgments on the costs, benefits, and the fairness of such proposals. I am sure their views will be made known as Congressional Committees begin consideration of the proposed legislation.

As work continues on last year's recommendations, preparations are being made for this year's effort. The Executive Committee of the Forum met in February and has announced that in June and July it will conduct a series of local forums in five cities throughout the nation. We were not completely satisfied with the proportion of participants in last year's Forum that were small business persons. By

conducting these forums in diverse geographic locations at various times, we hope to provide an opportunity for interested persons who are unable to attend a more distant Forum to present their views on existing problems and to comment on or propose potential remedies.

This year's forums will be held in Washington, D.C., Houston, St. Louis, San Francisco, and Boston. A panel of the Forum's Executive Committee members, including representatives of key federal agencies and departments, will attend and conduct each local forum. The Executive Committee will then prepare a report of the local forums, including proposed legislative and regulatory actions, to be presented to Congress and the appropriate regulatory agencies later this year.

Small business is a vital segment of our national economy. Various studies describe the importance of small business firms in the creation of jobs and technological innovations in the United States. Establishment of the Securities and Exchange Commission Government-Business Forum on Small Business Capital Formation has helped to affirm the government's interest in the small business sector. I believe the Forum is an important step in bringing the government and private sector together to consider measures to facilitate small business capital formation.

Government officials make significant contributions to the work of the Forum, but it is clear to me that the key ingredient in its success last year and in its continued success is the willingness of private sector participants to

give of their time and expertise. I encourage all of you to participate in the local forums conducted in your area of the country.

We will now be pleased to respond to any questions and to receive comments or suggestions you may have.