March 24, 2014

Elizabeth M. Murphy
Secretary
Securities & Exchange Commission
100 F Street NE
Washington, D.C. 20549

Re: File No. S7-11-13, Proposed Rule Amendments for Small and Additional Issues Exemptions under Section 3(b) of the Securities Act

Dear Ms. Murphy:

The Small Business Investor Alliance ("SBIA") is the premier organization of lower middle market private equity funds, small business investment companies ("SBICs"), limited partner ("LP") investors in these funds, and business development companies ("BDCs"). SBIA represents and advocates on behalf of almost 400 funds in the lower middle market space, including over 200 SBICs and 23 BDCs. SBIA's membership includes the largest representative group of BDCs and SBIA advocates on behalf of these members in an effort to ensure a healthy market, balancing investor protection and capital formation.

SBIA appreciates the opportunity to provide feedback on the Section 3(b)(2) exemption from the Securities Act of 1933 ("Regulation A+") proposal[1] advanced by the Securities & Exchange Commission ("Commission" or "SEC") with particular concentration on the ability of BDCs to utilize the Proposed Rules.

SBIA is pleased to offer following comments on the Proposed Rules:

1) BDC's Should Be Eligible To Utilize the New Section(3)(b)(2) Exemption To Facilitate Small/Emerging Business Capital Formation and Job Creation

[1] *"Proposed Rule Amendments for Small and Additional Issues Exemptions Under Section 3(b) of the Securities Act,"* Federal Register, Vol. 79, No. 15, January 23, 2014, pp. 3925-4065. Release Nos. 33-9497, 34-71120 and 39-2493; File No. S7-11-13 ("Proposed Rules").

BDCs were created under the Small Business Investment Incentive Act of 1980 ("1980 Act").[2] At the time, there was clear recognition by Congress that reform was needed to stimulate investment in small and emerging companies, particularly in the realm of venture capital.[3] This need for reform led to the creation of BDCs, which allowed a new structure for capital injection into small and growing businesses, accompanied by professional managerial expertise, elements recognized as necessary for job creation. The Jumpstart Our Business Startups ("JOBS") Act is a continuation of the goals of the 1980 Act in that it recognizes the engine of job growth is unleashed through regulatory reform that incentivizes increased capital injection into small and emerging companies.[4] It was enacted to address a crisis in capital formation, similar to that which existed in 1980.

The Commission has already recognized the role that BDCs play in providing capital to startup and emerging growth companies ("EGCs") in connection with Title I of the JOBS Act. The SEC Division of Corporation Finance's guidance in connection with Title I of the JOBS Act expressly provides for BDCs to access Title I:

> [G]iven the existing regulatory regime for BDCs and the context of the JOBS Act and its definition of "emerging growth company," [] BDCs may qualify as emerging growth companies. BDCs invest in startup and emerging growth companies for which they make available significant managerial experience, and are subject to many of the disclosure and other requirements from which Title I provides exemptions, including executive compensation disclosure, say-on-pay votes, MD&A and Section 404(b) of the Sarbanes-Oxley Act.[5]

Allowing BDCs to utilize Regulation A+ aligns closely with the Commission guidance in qualifying BDCs as "emerging growth companies" under Title I of the JOBS Act. The

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[2] Small Business Investment Incentive Act of 1980, Public Law 96-477, October 21, 1980.

[3] ("The venture capital industry has consistently maintained that it cannot operate and function efficiently under the strictures imposed by the 1940 Act and the result has been the creation of few new publicly owned venture capital firms and the lack of growth of those venture capital firms already in existence."); Richard J. Tashjian, *The Small Business Investment Incentive Act of 1980 and Venture Capital Financing,* FORDHAM URBAN LAW JOURNAL, Vol. 9, Issue 4, p. 866, 1980, *available at:* http://ir.lawnet.fordham.edu/cgi/viewcontent.cgi?article=1515&context=ulj; *see also* Steven B. Boehm, Cynthia M. Krus et. al., *Shedding New Light on Business Development Companies,* INVESTMENT LAWYER, Vol. 11, No. 10, October 2004, *available at:* http://www.sutherland.com/portalresource/lookup/poid/Z1tOl9NPluKPtDNIqLMRV56Pab6TfzcRXncKbDtRr9tObDdEv0JDp0!/fileUpload.name=/InvestmentLawyerOct04.pdf

[4] The Jumpstart Our Business Startups Act, Public Law 112–106, Apr. 5, 2012.

[5] http://www.sec.gov/divisions/corpfin/guidance/cfjjobsactfaq-title-i-general.htm

JOBS Act has been helpful to BDCs and SBIA members in raising capital to invest in small and midsize businesses. For example, one of SBIA's BDC members, Capitala Finance Corp. (NASDAQ: CPTA) recently went public in September 2013, conducting an initial public offering ("IPO") of 4 million shares and raising $80 million in capital to enable it to continue to invest in smaller and middle-market companies.[6] Capitala was able to utilize Title I of the JOBS Act and classified itself as an EGC in its registration statement, filed on Form N-2 with the Commission on May 30, 2013.[7] Capitala was preceded by CapitalSouth Partners, an SBIC manager which held multiple SBIC licenses with the Small Business Administration ("SBA"). In order to form their BDC and establish a sufficient track record of returns on their assets to attract underwriter and investor interest for an IPO, CapitalSouth utilized assets from their pre-existing SBICs to fund the BDC entity. Capitala's ability to utilize the "IPO on-ramp" in Title I of the JOBS Act was a helpful factor in their IPO process. In addition to Capitala, three other BDCs have also elected EGC status, including Goldman Sachs BDC, Inc., Harvest Capital Credit Corporation, and WhiteHorse Finance[8], further indicating the attractiveness of EGC status and the "IPO on-ramp" to these entities.

BDCs are a rapidly growing component in providing capital to small and emerging businesses and should be able to benefit from other provisions of the JOBS Act beyond Title I. As a result of new regulatory requirements imposed by the Volcker Rule[9], as well as the reduced amount of traditional bank lending to small and mid-sized private businesses[10], alternative lenders such as BDCs have emerged as an essential source of

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[6] Adam O'Daniel, *Joe Alala's Capitala Finance Corp. prices IPO at 20$ per share,* CHARLOTTE BUSINESS JOURNAL*, September 25, 2013,* available at: http://www.bizjournals.com/charlotte/blog/bank_notes/2013/09/joe-alalas-capitala-finance-corp.html?page=all

[7] Capitala Finance Corp. Registration Statement, Form N-2, filed on Mary 30, 2013, *available at:* http://www.sec.gov/Archives/edgar/data/1571329/000119312513241781/d505298dn2.htm.

[8] Goldman Sachs BDC, Inc. Registration Statement, Form N-2, filed on January 24, 2014, *available at:* *http://www.sec.gov/Archives/edgar/data/1572694/000089534514000019/ptn2a2_goldmanliberty.htm;* Harvest Capital Credit Corporation Registration Statement, Form N-2/A, filed on April 24, 2013, *available at:* http://www.sec.gov/Archives/edgar/data/1559909/000143774913004649/hccc_n2a2-040413.htm; WhiteHorse Finance, Inc. Registration Statement, Amendment No. 5 to Form N-2, filed on July 15, 2013, *available at:* http://www.sec.gov/Archives/edgar/data/1552198/000114420413039539/v350022_n2a.htm.

[9] *See* Final Rule, 17 CFR Part 255, Section _.10(c)(12)(iii).

[10] ("Most importantly, BDCs are filling a void in the capital markets for loans to small and midsize businesses that are currently underserved by the commercial banking community.") Eyal Seinfeld, *Business Development Companies and the JOBS Act,* Ernst & Young, July 2013, *available at:*

financing to emerging companies. For example, if Regulation A+ were available at the time Capitala was formed, Capitala could have raised equity capital to seed its BDC with assets comprised of investments in small businesses, either obviating the need for Capitala to acquire the CapitalSouth SBICs or providing *additional* capital to invest into smaller and middle market companies prior to Capitala's acquisition of the CapitalSouth SBICs and, ultimately, the consummation of its IPO. The ability to utilize Regulation A+ by these entities would be very helpful to ease the creation of new BDCs and facilitate the growth of this critical small and emerging business lending industry which actively creates jobs in the United States.

2) Tier II of Regulation A+ Could Be Critical to "Start-up" BDCs

Given the growing number of new BDCs in the financial services industry, allowing BDCs to utilize Regulation A+ would provide increased flexibility in their formation and ability to raise capital. An increase of the number of BDCs would likely result in lower borrowing rates for small and emerging corporations due to competitive pressures, providing a steady pool of financing. Tier II of Regulation A+ could prove to be a useful tool in the formation of new BDCs, particularly those that are not currently attached to a large fund family with an existing pool of assets to transfer.

Currently most BDC entities are seeded through debt financing from large institutions or through existing fund families. Increasingly, underwriters of BDCs seeking to conduct an initial public offering are requiring BDCs to have existing assets on their books showing immediate returns of up to 9 or 10%. As a result, it is increasingly challenging to conduct an offering of a "blind pool" BDC without established assets with sufficient returns.[11] The ability of BDC's to utilize Regulation A+ would provide another option for BDCs to seed their portfolios, if more traditional financing methods, such as debt financing, are unavailable. Often, traditional financing options are less available to issuers in the lower middle market space. These entities are very small, have concentrated portfolios (for example, bilateral loans to companies that aren't "banked", as opposed to broadly syndicated or high yield issuers that have access to efficient capital markets), or include non-senior secured loans (i.e., subordinated debt, preferred

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http://www.ey.com/Publication/vwLUAssets/Business_development_companies_and_the_JOBS_Act/$FILE/1307-1106095%20EYs%20BDC%20and%20JOBS%20Act_July%202013.pdf

[11] ("More recently there were a couple of BDCs looking to go public, but I would think that the volatility in the equity markets probably has put those deals on the side burner. I think the challenge for new entrants is most of them are trying to go public as a blind pool. So, you don't really have an existing dividend distribution upfront.") *See* Sakhrani, Sanjay, *New Challenge for Entrants into BDC Space is Going Public as a Blind Pool; Senior Vice President of Keefe, Bruyette & Woods Explains How In This Exclusive Interview*, THE WALL STREET TRANSCRIPT, November 30, 2011, *available at:* http://finance.yahoo.com/news/challenge-entrants-bdc-space-going-181200432.html.

or common equity) all of which are common products issued to investors focused on growth capital. Patient capital is often the answer to seeding these entities, as it is for BDC portfolio companies, and equity raised in accordance with the Regulation A+ regime could be a compelling alternative to conventional funding vehicles for these types of investment companies.

As a result of the need for this financing or seed capital, most recent BDCs engaging in an IPO have been affiliated with large private equity funds or those fund families who are able to transfer existing return generating assets over to the new BDC entity. BDCs without this significant financial backing, particularly those in the lower middle market arena, have a more difficult time gathering momentum in gathering these assets – and, as indicated above, Regulation A+ could be a helpful tool to help these BDCs achieve sufficient momentum to move towards an IPO. In this scenario, a newly-formed BDC entity could perform a Tier II offering under Regulation A+, rather than transferring existing assets, and grow their assets to generate sufficient returns to generate underwriter interest. The use of Regulation A+ by these "start-up" BDCs could encourage further small and emerging business investment as the number of BDCs could grow, promoting increased competitive pressure in the capital lending environment. The lower regulatory burdens imposed under Regulation A+ may also be preferential for "startup" BDC's, rather than the significant costs associated with initially conducting an IPO soon after formation.

3) Additional Disclosures for BDCs Beyond Those Contemplated In the Proposed Rules Are Not Necessary to Ensure Investor Protection

A number of previous comments on Title IV have voiced support for BDCs to be "eligible issuers" under Regulation A+[12], including some that have called for increased disclosure if BDCs are to be eligible.[13] SBIA believes existing disclosures in the Proposed Rules sufficiently balance investor protection and capital formation for BDCs utilizing the exemption. No additional disclosures are needed. The Proposed Rules indicate that Part 1 of Form S-1 will be an option for issuers to provide as the disclosure format for Part 2 of Form 1-A.[14] Form 1-A is the form that issuers must complete to elect the Regulation A+ exemption. Given that Part A of Form N-2 is substantially similar in terms of

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[12] *See* W.R. Hambrecht Letter Re: *Request for Public Comments on SEC Regulatory Initiatives Under the JOBS Act: Title IV, Small Company Capital Formation*, p. 2, January 4, 2013; American Bar Association Business Law Section Letter Re: *Request for Public Comments on SEC Regulatory Initiatives Under the JOBS Act: Title IV – Small Company Capital Formation*, p. 9, September 7, 2012.

[13] *See* North American Securities Administrators Association, Inc. (NASAA) Letter re: *Comments on SEC Regulatory Initiatives under the Jumpstart Our Business Startups Act: Title IV – Small Company Capital Formation*, pp. 6-7, April 10, 2013.

[14] Proposed Rules, p. 86.

disclosure requirements to Part 1 of Form S-1, the Commission should logically allow BDCs utilizing Regulation A+ to submit Part A of Form N-2 to satisfy the disclosure obligations in Part II of Form 1-A. The investor protection mandate would be dispensed through these public offering-like disclosures in Form N-2, including qualitative risk factors and financial highlights to the extent those exist.

If the Commission does believe some additional investor protections are needed for BDCs utilizing Regulation A+, it may think about limiting use of the exemption to certain BDC entities. SBIA does not believe this limitation is necessary, due to the disclosures already included in the Proposed Rules, but recognizes the SEC may feel differently. The Commission could limit the utilization of Regulation A+ by BDC entities to those that already hold SBIC licenses with the SBA. In the case of SBA-licensed BDCs, the SBA has already signed off on the quality of the underlying enterprise and conducted their due diligence on the management of the fund. This SBA vetting could be a benchmark to allow BDCs to utilize Regulation A+, while alleviating potential investor protection concerns.

4) SBIA Supports The Qualified Purchaser Definition In the Proposed Rules

SBIA commends the Commission for defining "qualified purchaser" as "any offeree and any purchaser in a Tier II offering" under Regulation A+. This definition will help to ensure that the new Regulation A+ is not held back from being a useful exemption and avoids the costs and regulatory burden associated with blue sky regulation. According to a Government Accountability Office ("GAO") study on the utilization of Regulation A prior to the JOBS Act, a significant factor in why the exemption was not utilized previously was due to the cost of compliance and time-consuming nature of registering the securities in individual states.[15] SBIA commends the Commission for recognizing this utilization concern and the Commission's effort to make Regulation A+ competitively attractive with Rule 506 of Regulation D. The "qualified purchaser" definition as it is written will ensure maximum utilization of Regulation A+ and allow it to achieve the relevance that "old" Regulation A was not able to achieve.

5) In the Final Rule, the Commission Should Address the Problem of Section 12(g) Triggers

[15] ("For example, one academic who has researched and written extensively about blue sky laws believes that they impose significant costs on small businesses and impair capital formation. According to this researcher, the costs to issuers of addressing blue sky laws have been a significant factor in the historic underuse of Regulation A by small businesses. An advocate for small businesses as well as securities attorneys with whom [GAO] met agreed with this assessment.") GAO Report to Congressional Committees, *Securities Regulation, Factors that May Affect Trends in Regulation A Offerings,* GAO-12-839, p. 17, July 2012.

The Commission must take steps to address the issue of registration triggers under Section 12(g)(1). Section 12(g)(1) of the Securities Exchange Act of 1934 ("Exchange Act") requires a company to register its securities if it has assets of $10 million or more and more than 2,000 holders of record or 500 holders of record who are not accredited investors.[16] These triggers make the use of Tier II of Regulation A+ problematic for issuers seeking to raise capital from retail investors up to the $50 million limit, due to the 499 non-accredited investor cap. It is highly unlikely that retail investors will purchase significant sums of these Regulation A+ securities, particularly with the caps on individual investment in the Proposed Rules, thereby easily triggering section 12(g)(1). For all practical purposes, issuers seeking to raise a significant amount of capital under the exemption will be forced to become a full reporting company under Section 13 of the Exchange Act. As a result, Tier II of Regulation A+ may appear less attractive in comparison to Regulation D offerings, particularly those under Rule 506.

The utilization of Regulation A+ primarily hinges on a comparison of its benefits by the issuer with offerings under Regulation D, primarily Rule 506. A Rule 506 offering would allow an issuer to raise significant capital, with limited up front cost and no ongoing reporting obligation, exemption from blue sky laws, although with the restriction of only being able to offer these securities to accredited investors. In contrast, Tier II offerings under Regulation A+ require moderate up front cost and ongoing reporting obligations, with the benefit being that these securities can be sold to retail, non-accredited investors, there is no need to register the offering at the state level, and the securities are not restricted. If the trigger under Section 12(g) is not raised or remedied in the case of the exemption, then any significant offering under the exemption would require more than 499 holders of record to purchase the securities to raise any significant amount of capital. This therefore would require the issuer to register as a fully reporting company under Section 13 of the Exchange Act.

Being required to register at this early stage in a company's lifecycle could be immensely destructive to the issuer. According to the Commission, the costs of SEC registration hover around $2.5 Million, with an average cost of 1.5 million in ongoing compliance costs as a reporting company.[17] The triggers under 12(g)(1) would also result in the potential destruction of the benefits of having an unrestricted security that can be bought and sold in the secondary market. Issuers would take care to avoid the section 12(g) triggers and ultimately voluntarily limit the size of their offering, making Tier II of Regulation A+ less effective for capital raising purposes and diminishing usage of the exemption.

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[16] 15 USC 78l(g)(1).

[17] Proposed Rules, "Crowdfunding," *Federal Register*, Vol. 78, No. 214, November 5, 2013, p. 66509.

Another concern is the Commission's claim that broker-dealers will hold Regulation A+ securities in "street name", therefore claiming that movement of the section 12(g) triggers is not necessary. The Commission states that following in the Proposed Rules:

> Because of the manner in which shareholders of record are tabulated, the likelihood of a Regulation A issuer triggering the 12(g) threshold is low if not triggered at the time of offering. In particular, beneficial owners of Regulation A issuers who hold their shares at a broker are not counted as a record holder. Their shares, held in ''street name,'' are counted at the broker level, so that each brokerage at which there is a least one beneficial owner would constitute one shareholder of record. Because of this treatment, the number of shareholders of record is often significantly less than the number of beneficial owners.[18]

The Commission may be mistaken on this issue for the following reasons. First, the number of investors in any Regulation A+ issuer will be relatively small in scale and therefore the number of investors that are clients of a particular broker-dealer will also likely be small. The economies of scale achieved by the broker-dealer in holding the Regulation A+ security in street name will therefore not be present. Second, there may not be an active secondary market for Regulation A+ securities and this will raise particular valuation issues that are presented with illiquid securities. These valuation concerns are a disincentive for broker-dealers to hold Regulation A+ securities in street name. Third, as Regulation A+ securities are not restricted securities, they will be sold to other investors and these follow-on investors will result in more overall holders of the securities. Fourth, broker-dealers who did not underwrite the Regulation A+ offering will have no economic incentive to hold these securities in street name, as it is unlikely they will act as a market-maker in the security. Finally, issuers that take a conservative approach will have to assume that all investors will be direct investors in the security, due to the forgoing uncertainties that broker-dealers will hold the security in street name. In sum, the Commission must take action to remedy the section 12(g) triggers that will limit overall use of the exemption.

6) The Commission Should Consider Allowing For The Development of "Venture Exchanges" To Increase the Liquidity of Regulation A+ Securities

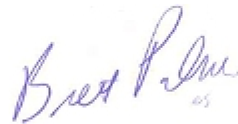
One idea that has come up and is worthy of consideration by the Commission is the creation of "venture exchanges" to facilitate the trading of Regulation A+ securities. SBIA believes the Commission should encourage the development of "venture

[18] Proposed Rules, pp. 236-237.

exchanges" or other trading venues that are focused on facilitating the secondary market trading in the securities of Regulation A issuers by reducing the regulatory risks and burden for both issuers, broker-dealers and exchanges dealing with Regulation A+ securities. Commissioner Gallagher highlighted the issues of "venture exchanges" in recent remarks at the FIA Futures and Options Expo in November 2013.[19] The Commissioner noted that the SEC's Advisory Committee on Small and Emerging Companies had recommended that the Commission facilitate the creation of a distinct marketplace for the securities of small and emerging companies. This exchange would need special exemptions from the current exchange framework, including Regulation NMS. SBIA believes the creation of such exchanges would be a helpful step to ensure a liquid marketplace for Regulation A+ securities, therefore contributing to the effectiveness of the new Tier II offering structure in the Proposed Rules and its overall utilization rate.

In conclusion, SBIA appreciates this opportunity to share our thoughts on the Proposed Rules and stands willing to discuss our comments and any other ways in which the SEC can encourage capital formation and job creation in small, mid-size, and emerging businesses.

Sincerely,



Brett Palmer
President
Small Business Investor Alliance

[19] *See* Remarks delivered by Commissioner Daniel M. Gallagher, FIA Futures & Options Expo, November 6, 2013, *available at:* http://clsbluesky.law.columbia.edu/2013/12/02/commissioner-gallagher-discusses-venture-exchanges/