



**SMALL BUSINESS PROPOSALS**

**OPENING STATEMENT OF**

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

**AT THE PUBLIC MEETING OF THE COMMISSION**

**WASHINGTON, D.C.**

**MARCH 11, 1992**

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

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CHAIRMAN, SECURITIES & EXCHANGE COMMISSION  
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Good morning. This is an open meeting of the Securities and Exchange Commission on March 11, 1992 to consider proposals relating to small business finance.

Small businesses are critical to the American economy. The roughly 20 million small businesses in the United States employ more than half our labor force and produce about that share of our gross domestic product. Small businesses account for a substantial share of the innovations that have created whole new industries, such as aviation, biotechnology and personal computers. Small businesses also create most new jobs in the country.

Capital is critical for any business. It is especially critical for small businesses seeking the funds necessary to develop new products, hire new employees, build new facilities. Traditionally, before they were large enough to tap the securities markets directly, small businesses looked to their local banks and venture capitalists for capital. Today, these traditional sources do not appear to be meeting the needs for finance among smaller firms, including start-up companies.

Congress has often asked the Commission to reduce the regulatory costs for small businesses seeking to raise capital. Indeed, in 1933, in the original Securities Act, Congress allowed the Commission to exempt offerings of up to \$100,000 from the registration requirement. Congress has repeatedly increased this limit "to assist small business in raising capital." In the Small Business Capital Formation Act of 1980, Congress directed the Commission to "use its best efforts" to "reduce the costs of raising capital" for firms with market capitalizations of less than \$25 million.

Of course, Congress has also charged the Commission with protecting investors by requiring full disclosure. There is nothing inconsistent, though, about investor protection and small business capital formation. In particular, there is not anything in these proposals that would encourage penny stock fraud by non-existent companies as we have seen all too often in the past.

The Commission has vigorously prosecuted illegitimate or nonexistent small businesses attempting to sell securities through false or misleading statements as well as the brokerage firms peddling worthless stock. We will continue to do so. However, the reality that some will break the law under any circumstances should not prevent us from making the law flexible

and constructive for the honest and legitimate companies in search of investors.

Today's proposals include many specific changes to existing SEC rules, as well as specific proposals to amend the Securities Act of 1933 and the Investment Company Act of 1940. Every one of these proposals is designed to be fully consistent with strong levels of investor protection, yet to make our overall system more flexible and less costly for small businesses seeking to raise capital. While each specific change needs to be examined in its turn, it is important also to evaluate the objectives of the collective package.

As a group, these proposed changes are designed to move toward several goals:

First, our system of disclosure is unparalleled and provides numerous benefits to investors. However, over the years it has become too complex and too legalistic. The prime beneficiaries of undue complexity are lawyers, not investors. These rules are designed to begin a long term process of clarifying and simplifying requirements so that good disclosure is not so heavily encrusted with legal boilerplate as to create excessive costs to using the market to raise capital. This problem is especially severe for smaller businesses, for whom a \$200,000 bill for legal and accounting services in an offering often simply means "no offering" at all.

The new form SB-1 and the new 10-K and 10-Q Junior forms are designed to move in the direction of documents that the owner of a small business can prepare with far lower costs for outside professional advice.

Second, these proposals are designed to make it easier for a small business to tap the capital markets for funds at an earlier point in the life cycle of the company. Here the problem is to create opportunities for small offerings by really small companies to provide vital working capital before the point at which a "traditional" wide scale public distribution could occur.

Third, these proposals are designed to make it easier and less costly to form collective investment vehicles like venture capital funds, and for existing institutional investors such as mutual funds to invest a portion of their assets in the securities of smaller companies. For the long run this will hopefully entail the development of an entirely new type of security that would represent an interest in a pool of small business obligations. This "securitization" of small business financial obligations could provide obligations that would be desirable for institutional purchasers and also beneficial to small business loan originators like banks.

Hopefully, these efforts would in the aggregate significantly improve our overall capacity to finance the creation and growth of new companies, with many new opportunities for investors.

Among other things, today's regulatory proposals would:

- Create a single, simple disclosure system for small businesses. An entirely new offering form -- Form SB-1 -- is being proposed for any offerings by businesses with annual revenues less than \$15 million. This form is intended to be much simpler to use than the traditional registration forms like the S-1.
- In addition to the new "Small Business" registration form, these proposals would also create a new series of "small business" forms under the Securities Exchange Act of 1934. Like the SB-1, the new "10-K Junior" and "10-Q Junior" will be written in plain English and will hopefully be easier to use than the existing forms for larger companies.
- Increase from \$1.5 million to \$5 million the amount of securities that can be offered under Regulation A.
- Allow small businesses using Regulation A to "test the waters" for investor interest before they begin selling their securities.
- Allow a Small Business Investment Company to issue \$15 million, rather than only \$5 million, of securities under Regulation E each year.
- Increase from 10% to 15% the percentage of illiquid assets like small business securities that an open-end mutual fund can hold.

Among other things, today's legislative proposals would:

- Relax the attribution rules used to determine whether a company has under 100 investors and is thus exempt as a "private investment company."
- Create a "qualified investor investment company exception," parallel to Rule 144A, to allow any number of qualified investors to form an investment company.
- Increase from \$5 million to \$10 million the Commission's authority to exempt small issues from Securities Act registration requirements.

- Increase from \$100,000 to \$10 million the amount of securities that can be issued by an exempt intrastate investment company.
- Relax some of the requirements for Business Development Companies, investment companies that specialize in small business investment.