FINAL REPORT
OF THE
SEC GOVERNMENT-BUSINESS FORUM
ON
SMALL BUSINESS CAPITAL FORMATION

June 1997

This report has been compiled by the staff of the Division of Corporation Finance, U.S. Securities and Exchange Commission. The views and recommendations in this report, however, are those of the Forum participants and not of the Commission, the Commissioners or any of the Commission's staff members.

PREFACE

In 1996, the Government Business Forum on Small Business Capital Formation met in Washington, D. C. The recommendations from the 1996 Forum follow. We believe that many worthwhile proposals are evidenced. The participants gave careful consideration to a wide variety of issues, including, once again the recommendations of the 1995 White House Conference on Small Business.

One purpose of the Forum is to give the capital-raising needs of small business greater attention, with the hope that these needs may be accommodated, in balance with appropriate, and necessary governmental regulations to safeguard the public interest. It is apparent from the following recommendations of the Forum participants that this purpose has been well served. We thank them for their efforts and are pleased to present this report.

The Executive Committee for
the Fifteenth Annual SEC
Government-Business Forum on
Small Business Capital Formation

EXECUTIVE COMMITTEE

Chairman:

Albert S. Dandridge, III
Associate Director
Division of Corporation Finance
U. S. Securities & Exchange Commission

Mary E. T. Beach
Consultant

E. Olena Berg
Assistant Secretary (Pension and Welfare Benefits Administration)
U. S. Department of Labor

Janice Booker
Director, Community Development Division
Office of Comptroller of the Currency

Michael S. Caccese
Senior Vice President & General Counsel
Association for Investment Management & Research

Chip Cooper
Executive Director
Missouri Innovation Center

Gregory Dean
Assistant Chief Counsel for Advocacy
U.S. Small Business Administration

Jerry Feigen
Adjunct Professor, Georgetown University Law Center;
President, Jerry Feigen Associates

John Paul Galles
Executive Vice President
National Small Business United

Bruce Gamble
President
National Association of Investment Companies

Bruce Goldberg
Entrepreneurial Advisory Services Group
Coopers & Lybrand

Barry C. Guthary
Director, Massachusetts Securities Division

John J. Huntz, Jr.
Senior Vice President
Vista Resources, Inc.

Daryl Jackson
Daryl Jackson Associates

Charles Ludlam
Executive Director
Biotechnology Industry Organization

James McCall
President
California Capital Access Forum

E. Bums McLindon
Councilor, Buchanan & Mitchell
(Representative of the American Institute of Certified Public Accountants)

Peter McNeish
President
National Association of Small Business Investment Companies

Marc H. Morgenstem
Kahn, Kleinman, Yanowitz & Amson
(Representative of the American Bar Association)

John J. Motley, III
Vice President
National Federation of Independent Business

Alien Neece
Neece, Cator & Associates, Inc.

Karen O'Brien
General Counsel
North American Securities Administrators Association

Douglas F. Parrillo
Senior Vice President, Communications
National Association of Securities Dealers

Martha Scanlon
Deputy Associate Director, Division of Research and Statistics
Board of Governors of the Federal Reserve System

Herbert Spira
Tax Counsel
Independent Bankers Association of America

Wayne Upton, Jr.
Project Manager
Financial Accounting Standards Board

Clay H. Womack
President
Direct Stock Market, Inc.

CORE PRESENTERS
TAXATION ROUNDTABLE

Moderator --
Daryl Jackson
Daryl Jackson Associates
11 South Oak Street
Falls Church, VA 22204

Along with --

Charles Ludlam
Executive Director
Biotechnology Industry Organization
1625 K Street, N. W.
Suite 1100
Washington, D. C. 20006-1604

Russ Orban, Assistant Chief Counsel for Tax Policy
Office of Advocacy
U. S. Small Business Administration
409 Third Street, S. W.
Washington, D. C. 20416

Benson Goldstein, Esq.
Goldstein & Associates
3 Bethesda Metro Center
Suite 750
Bethesda, MD 20814

CREDIT ROUNDTABLE

Moderator --
Gregory Dean, Assistant Chief Counsel For Advocacy
U. S. Small Business Administration
409 Third Street, S. W.
Washington, D. C. 20416

Along with --
Raphael W. Bostic
Division of Research and Statistics
Federal Reserve Board
20th Street & Constitution Avenue
Washington, D. C. 20551

Roger Tufts, Senior Economic Advisor
Office of the National Bank Examiner
Office of the Comptroller of the Currency
Washington, D. C. 20219

Michael Dowd, Director
Office of Loan Programs
U. S. Small Business Administration
409 Third Street, S. W.
Washington, D. C. 20416

Maurice Zeitler, Program Coordinator
Community Development Division
Office of the Comptroller of the Currency
Washington, D. C. 20219

SECURITIES I ROUNDTABLE

Moderators --
Marc H. Morgenstern, Esq.
Kahn, Kleinman, Yanowitz & Arnson

The Tower at Erieview
Suite 2600
Cleveland, Ohio 44114-1824

Mary E. T. Beach, Consultant
6543 Jay Miller Drive
Falls Church, Virginia 22041

Along with --
Brian J. Lane, Esq.
Director, Division of Corporation Finance
U. S. Securities and Exchange Commission
450 Fifth Street, N. W.
Washington, D. C. 20549

Karen M. O'Brien, General Counsel
North American Securities Administrators Association, Inc.
One Massachusetts Avenue, Suite 310
Washington, D. C. 20001

David A. Sirignano, Esq.
Associate Director
Division of Corporation Finance
U. S. Securities and Exchange Commission
450 Fifth Street, N. W.
Washington, D. C. 20549

Roland M. Machold
Director, New Jersey Division of Investment;
former Vice President, Morgan Stanley & Co.

SECURITIES II ROUNDTABLE

Moderators --
Jerry Feigen
Jerry Feigen Associates, Inc.
2000 Century Plaza, Suite 308
10632 Little Patuxent Parkway
Columbia, MD 21044

Lee Petillon, Esq.
Petition & Hansen
1260 Union Bank Tower

21515 Hawthorne Boulevard
Torrance, CA 90503

Along with --
Kenneth J. Berman, Esq.
Assistant Director, Division of Investment Management
U. S. Securities and Exchange Commission
450 Fifth Street, N. W.
Washington, D. C. 20549

Joan Sweeney
Allied Capital
1666 K Street, N. W.
Suite 901
Washington, D. C. 20006

Bruce Shewmaker
New Century Management, Inc.
12 Briarwood Drive
Short Hills, NJ 07078

Mark Heeson
National Venture Capital Association
1655 North Fort Myer Drive
Suite 700
Arlington, VA 22209

Lee Mercer
National Association of SBICs
1199 N. Fairfax Street
Suite 200
Alexandria, VA 22314

Terry Bibbens
Entrepreneur in Residence
U. S. Small Business Administration
409 Third Street, S. W.
Washington, D. C. 20416

Donald Christensen
Associate Administrator for Investments
Investment Division
U. S. Small Business Administration
409 Third Street, S. W.

Washington, D. C. 20416

1997 FORUM STAFF

Regina Baker

Anthony Barone

James Budge

Christina Chalk

Maureen Dallman

Edsel Guydon

Barbara Jacobs

John F. Murphy

Jay Pitts

Michael Ryan

Antonio Stanco

William Toomey

Jacqueline Walker

Donald Wiland

Richard K. Wulff

Twanna M. Young

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I. SUMMARY OF FORUM RECOMMENDATIONS

RECOMMENDATIONS FROM THE WHITE HOUSE CONFERENCE

That the Forum reaffirm endorsement of Recommendation 14 of the 1995 White House Conference on Small Business Recommendations, as follows,

To increase the availability of growth capital to invest in small businesses, Congress should:

a) Further privatize the Small Business Investment Company (SBIC) program, now administered by the SB A, by creating a new, government sponsored, but privately managed, corporation named Venture Capital Marketing Association or "Vickie Mae" that would function similar to the Federal National Mortgage Association (Fannie Mae);

b) Extend the capital gains tax deferment currently afforded investments rolled into Specialized Small Business Investment Companies (SSBICs) to include investments in SBICs to encourage more investment in new SBICs;

c) Remove barriers to pension funds, foundations and endowments wishing to invest in SBICs and SSBICs; eliminate the "unrelated business taxable income" (UBTI) tax on all such activities; and

d) Reduce the minimum capital size requirements for establishing SBICs owned by regulated financial institutions, thereby encouraging them to provide equity to small businesses provided that no leverage is utilized by such SBICs until current minimum capitalization for leverage is achieved.

As was adopted in the March 1996 Final Report of the SEC Government-Business Forum on Small Business Capital Formation, this year's forum reaffirms and believes that proposition 286 warrants further consideration:

286. The U. S. Small Business Administration is vital to the growth of small business in America. Efforts to make the SBA's programs more cost effective and efficient should be continued and encouraged. The SBA's "independent" agency role as the primary supporter of small business within the Federal Government should be enhanced by:

a) Elevation of the U.S. Small Business Administration to a congressionally approved cabinet level position.

b) Budget allocations to maintain, increase, and enhance the 7(a) Loan Guaranty Program.

c) Budget allocations to maintain, increase, and enhance the 504 Loan Program.

d) Budget allocations to make permanent the Small Business Development Center Program which provides business assistance to small businesses nationwide.

e) Permanent maintenance of the "independent role" of the U.S. Small Business Office of Advocacy.

f) All other SBA programs should be reviewed with substantial input from the private sector. Any programs deemed to be ineffective should be eliminated.

TAXATION

Preamble

Small business recognizes the rationale for taxes and understands the need to pay tax to support government. However, we arc opposed to taxes that have the result of diminishing the capital that provides growth needs of small business to generate GDP and jobs. Simplified, fair, understandable taxes are necessary. Any administrative action that burdens small business is counterproductive to profitability of business needed for continuance. We feel these recommendations target the source of these objectives and will resolve many, but not all, of the current problems.

Primary Recommendations

Fundamental Tax Reform

It is the consensus of the Forum that current tax law and regulations promulgated thereunder unduly hinder the ability of small business to attract and maintain the capital necessary for formation and growth. It is for this reason that the Forum submits the following recommendations to promote fundamental tax reform and totally abolish the complicated present system. Congress should enact legislation that replaces the present system with a single comprehensive simple tax for individuals and businesses that eliminates double taxation. We recommend a system that encourages savings and is not difficult or costly to comply with.

Social Security Fundamental Reform

We urge the Congress enact legislation to reaffirm the stability of the existing Social Security System and to guarantee the commitments for all current participants. In the interests of increasing capital formation in the U. S. and assuring a more productive national retirement system, we recommend that an optional system be designed to eliminate intergenerational funding. This system would eventually replace the existing Social Security system.

Overall Capital Gains Reform

Congress should reinstate a 50% capital gains exclusion on sales of capital assets held more than one year.

Estate Tax Reform

Estate Taxes negatively impact small business in capital formation, job creation and business continuity; therefore, our Forum calls on Congress to repeal the Federal Estate and Gift Tax.

Secondary Recommendations

Targeted Capital Gains Reform

Congress should enact a targeted capital gains law that promotes the long-term investment in qualified small businesses. This law should include the following provisions:

a) A capital gains exclusion of at least 50% of the regular capital gains tax rate for an investment in a qualified small business that should include all forms of business entities, including pass-throughs.

b) The exclusion should increase as the holding period increases to promote the concept of "Patient Capital."

c) A tax of not more than 10% (preferably zero tax) should be imposed on the sale of a majority interest in a qualified small business held for more than 15 years.

d) A deferral of the gain on the sale of an interest in a qualified small business if the proceeds are reinvested in another qualified small business within two years.

e) A qualified small business should be an active operating business.

Independent Contractor Reform

The definition of an independent contractor must be clarified. Congress should recognize the legitimacy of an independent contractor.

a) The 20-factor test is too subjective. The number of relevant factors should be narrowed with more definitive guidelines for implementation. Realistic and consistent guidelines should require one of four criteria plus a written agreement. The criteria are (1) realization of profit or loss; (2) separate principal place of business; (3) making services available to the general public; or (4) paid on a commission basis.

(b) Safe-harbor provisions should be established that would protect the hiring business from the burdensome penalties currently being assessed by the IRS. De minimis rules based on dollars paid, hours worked, years in business, and/or specified closed-end projects should be established.

(c) The IRS should eliminate back taxes for misclassification when Form 1099's are filed and there is no evidence of fraud.

(d) Congress should specifically allow employers and independent contractors to provide joint technical training and to jointly utilize major specialized tools without jeopardy of reclassification of the independent contractor to employee status.

(e) Changes and implementation processes should be formulated by a joint committee of legislators and small business people.

IRS Reform

To prevent excessive taxpayer expense and erosion of capital to small business, we recommend that a reform be instituted to hold the IRS accountable for its actions as a unified body at all levels. We recommend that a training program

and a communication network be put into place that would ensure that all levels of the agency operate in compliance with all laws and regulations that are in place such as the 1996 Small Business Regulatory Reform Fairness Act. The standard for this should be set that institutes a training and development relationship with taxpayers. "Punitive" penalties should not be unreasonable to the "offenses" they address. Congress should review the collection penalty rates named in Section 6656 of the Omnibus Budget Reconciliation Act of 1989 (Public Law 101-239).

We suggest that an independent agency be available at the election of the taxpayer as a mediator in instances where the taxpayer feels "unregulated" authority has been exercised. The agency would be empowered to resolve disputes. This would not be applicable in cases of prior offense taxpayers.

This recommendation would also include special provisions for an innocent party or to a sincere hardship case.

Qualified Pension Fund Reform

The Congress should modify current law to allow an individual to invest under current limits, his or her own self directed qualified pension or profit sharing plans in his or her own small business. These funds could be used as a direct investment or as collateral to obtain debt financing.

ERISA Reform

In order to create and preserve capital for small business and its employees, Congress shall reform ERISA so as to allow employers to design qualified employee plans to suit employers and employees goals and needs, including but not limited to liberalization of vesting schedules, repeal of top heavy restrictions and adoption of reasonably prudent investment policies.

Investment Reform

In order to enhance the attractiveness to investors of small business investment, Congress should authorize a new investment instrument known as the Small Business Participating Debenture that could provide two components of "interest", a guaranteed portion at a stated rate, and a participation contingent upon an agreed share in issuer profits. The participating component of "interest" would be taxed to the investor as long term capital gain, but deductible by the issuer as interest. Investor losses would be deductible against ordinary income similar to Section 1244 stock.

[NOTE: ADDITIONAL TAX-RELATED RECOMMENDATIONS ARE OFFERED IN THE SECURITIES REGULATION -- INVESTMENT COMPANY ACT OF 1940 SECTION OF THIS REPORT]

CREDIT

Congress should establish and implement a cost-benefit analysis method of evaluation to review the loan programs and Business Assistance Programs of the SB A. This analysis should identify program costs and the ultimate benefits generated by these programs in terms of job creation and retention, tax revenues generated, and the economic impact on the local and national business environment.

Congress should evaluate action to facilitate:

-- the investment by mutual funds and public and private investment funds into investment grade securities of securitized small business loans; and

-- examining credit enhancement mechanisms to further facilitate small business loan securitization by public and private resources.

A program should be developed by the SB A, the lending industry, the SEC and/or Congress that will further leverage the SBA secondary market by providing a mechanism for the pooled securitization of the unguaranteed portion of SBA loans.

The SBA should continue to evaluate the nature and character of long-term technical assistance provided by the Women's Business Development Programs, as well as the pre-qualification programs, in order to further preserve and enhance such programs.

The SBA should continue to evaluate and expand upon the reach of and incentives for the SBA micro-loan program.

The banking regulators should permit financial institutions to utilize credit scoring as a tool but not as the major consideration in loan lending. Credit scoring should not be used in a manner that results in racial discrimination. In this regard, area and zip codes, as well as any other information that may result in racial discrimination, should not be used as a determinant in credit scoring models.

Environmental lender liability concerns of lending institutions should not exist where such institutions have only taken a financial position in real estate related

loans (i.e., either directly or as collateral) and not in a managerial/administrative capacity.

The SBA should examine the costs and benefits of using alternative rate structures (e.g., alternative to the prime rate stipulated in the law) as the index rate for alternative-rate loan arrangements. Alternative rates could include Treasury bill rates or other money market rates. Long negative cash flow amortization structures should also be examined, accordingly. In this regard, it should be noted that over the past several years, the prime rate has become more rigid in adjusting downward when market rates decline. Small business borrowers with adjustment-rate loans have not benefited from declines in the market rates. More flexible index rates may help.

The SBA's Business Information Center programs("BIC's") should be maintained and enhanced. A database of business assistance programs made available by the SBA and other federal agencies should be maintained at each BIC. Entrepreneurial training programs should be fostered through these BIC's, providing business plan development and loan packaging training on an international and domestic level to potential business clients and lenders. Use of technology to maintain and disseminate information via the Internet in conjunction with the SBA's web site should be encouraged at each of these centers.

In our ever changing global economy, international sales provide a significant growth opportunity to small businesses. New market penetration and profit potential benefit the entrepreneur while the government is encouraged by resulting employment growth, reinvested domestic earnings and improved balance of trade deficits. Unfortunately, banks, especially those lending with an asset based orientation, effectively exclude financing such international sales and/ or resulting receivables. Efforts should be made to encourage or even mandate to some degree that banks avail themselves of the several guarantee/insurance programs already in place by the Department of Commerce, SBA, Export-Import Bank and many of the states. Such programs generally provide financing for these export contracts/sales while leaving the banks' collateral and security intact.

SECURITIES REGULATION

Securities Act of 1933

The Commission should increase the transaction amount ceiling of Rule 504 to $5 million from $1 million.

The Commission and the states should implement a national "test the waters" provision for small business offerings.

"Test the waters" materials should be permitted for all Reg. D offerings.

The Commission should eliminate the general solicitation restriction for all Regulation D offerings.

General solicitation and advertising for accredited investors should be permitted without restriction.

The prohibition on general solicitation for Rule 505 and 506 offerings should be relaxed in order to allow small businesses to find accredited investors. One possibility would be to create a safe harbor for communications with anyone that the offeror reasonably believes to be accredited.

The intrastate exemption should be expanded to states contiguous to the principal place of business of the company.

The Commission should reexamine Rule 147 with a view towards modernizing the safe harbor, including the elimination or relaxation of the triple percentage tests and the addition of a substantial compliance provision modeled upon Rule 508.

A multi-jurisdictional regional offering exemption is a desirable expansion of the exemptive scheme from registration best achieved with the least effort by adopting a new Rule 504 A with a dollar amount ceiling of $5 million, if the offering is authorized for sale in the states where the offers are intended to be made, with a required delivery of a disclosure document.

The Commission should adopt a new exemptive rule under Section 3(b) of the Securities Act permitting offers and sales of securities within regional areas. A regional area may be defined by an established market area, metropolitan area or a geographically limited area.

The relationship between a monetary measure for "accreditation" of investors and actual sophistication as it relates to the investor's ability to fend for his or herself in financial matters (i.e.. Does a monetary measure oversimplify and exclude those who are truly accredited, and able to fend for themselves?) should be reconsidered. All accredited and sophisticated investors should be permitted to see and invest in all private placements on a system after the moment of accreditation regardless of when the private placement is posted, and encourage states to adopt the same standard.

Sales only should be subject to regulation, rather than offers to sell securities.

Provide a safe harbor for forward looking statements included in offering documents of private placements and IPOs.

There should be a bottom up review of the Securities Act and the Securities Exchange Act as they relate to the access to capital for small businesses. A task force should be created composed of staff of the SEC, NASAA, private industry and "gatekeepers" such as private attorneys and accountants to thoroughly reevaluate these Acts as they relate to small business.

In light of the new concept of "Company Registration" examine the possibility of small business 12(g) reporting category that facilitates reporting by small businesses and that would remove the trading restrictions of Rule 144, create a lower level of required disclosure for companies between $10 and $25 million, and move from quarterly to semiannual reports.

The Commission should adopt company-based registration but the ability of small issuers to utilize transaction-based registration should be retained as a parallel system for the purpose of protecting small issuers' access to the public capital markets.

Securities Exchange Act of 1934

The regulators should provide a broker/dealer exemption for Finders. A Finder would be defined as a person who arranges for investors to acquire securities of a business.

The Commission and the states should create/provide an exemption for Finders who are not registered broker/dealers. A Finder would be defined as a person who occasionally arranges for investors to acquire securities of a business. Non-broker/dealer Finders would not be subject to any qualifications criteria including, but not limited to, testing, bonding or reporting. The activities of a non-broker/dealer Finder may be circumscribed by the amount of compensation received or involvement with a specified number of transactions.

A limited class of broker dealer should be created that is enabled to raise capital for small business offerings, especially as it relates to using the Internet. This class would include a sub-set of broker dealers subject to a less rigorous series exam, be prohibited from handling money, and only permitted to do primary offerings.

A new class of "Finder-Broker Dealers" should be created to develop a new professional class dedicated to locating "Angels" to provide capital to

entrepreneurs. These individuals would be licensed to arrange "private placements" only.

A licensing requirement should be created for "financial public relations" people.

Registered broker-dealers should be allowed to share fees with non-registered broker-dealers provided that full disclosure of the fee-splitting arrangement is given to the customer.

Investment Company Act of 1940

The Commission should provide a method similar to that currently in place with "no action" and interpretative letter guidance whereby investment companies could rely upon the facts and circumstances utilized by others in securing Commission relief under section 6(c) of the '40 Act.

The "affiliated transactions" provision in section 57 of the '40 Act should be updated to provide flexibility.

The possibility of facilitating investment by the average American investor in mutual funds designed for investments normally classified as "Venture Capital" should be examined in light of the constraints imposed by the Investment Company Act of 1940.

A safe harbor should be established in the '40 Act for the "mark to market" evaluation of investment companies' portfolio of illiquid investments in small businesses to protect directors of such companies from possible liability by using the SB A's valuation policy as a guideline.

An exemption should be established from the '40 Act for a publicly-held venture fund where the fund is:

-- a non-leveraged SBIC regulated by the SBA with a minimum capitalization of $5 million;

-- an intra-state fund of $10 million (increase from the current $5 million);

-- comprised of qualified purchasers, defined as individuals with assets of $5 million or more, institutions with $25 million of more, and others as the SEC may define by regulation;

-- a state chartered economic development fund with 80% of the financing raised from accredited investors resident in the state;

-- 30 percent funded by 3 large institutional investors as defined by SBA regulation.

The 200 percent asset coverage limitation imposed on BDCs by section 61(a)(l) of the '40 Act is too restrictive and should be raised or removed.

The BDC provisions of S-1815 regarding the issuance of stand alone options and rights should be adopted and implemented immediately. This will:

(a) broaden the investor base for BDCs by allowing institutional investors to stage-in their capital commitments, and

(b) enhance aftermarket trading and stockholder liquidity by balancing investment appeal between retail (individual) investors and institutions.

Present securities regulation should be modified to permit BDCs to make scheduled (binding) rights offerings to all existing stockholders during the 5 years after the IPO. This will:

(a) allow individual investors the option to "stage-in" their capital to BDCs similar to institutional investors, and

(b) enhance the individual investor's rate of return without the obligation to provide more capital.

A current yield to investors in BDCs should be provided by enacting a tax credit or tax deduction of 10% annually for the first 5 (five) years after the IPO of the BDC and recapture the tax impact by having the BDC pay a surtax of 10% of all capital gains when realized (until recapture). This will:

(a) improve the marketability of BD Cs by enhancing the aftermarket trading of the BDC's stock and mitigating the NAV discount of newly formed BDCs, and

(b) establish permanent pools of risk capital that provide capital for job creation long after the tax revenue neutral impact is complete.

Exempt private fund managers (with more than $100 million of private equity under management) from the affiliate rules involving joint transactions with common portfolio companies among funds while retaining oversight by the BDC's independent directors. This will:

(a) encourage some of the most experienced professional venture fund managers to make their expertise and deal flow available to a broader range of retail and small institutional investors, and

(b) remove a major regulatory impediment to attracting the fund management talent necessary to bring major bracket underwriters and institutions to BDCs.

Remove the "liquidity penalty" of fund managers by enacting capital gains taxation treatment of incentive compensation regardless of the structure of the BDC (Corporate or partnership). This will:

(a) eliminate the tax penalty on fund managers who provide their investors with the BDC's benefits of liquidity, and

(b) align the long term return on investment interests of the BDC's managers with their investors.

Subchapter M of the Tax Code imposes diversity tests on investment companies registered under the '40 Act that are too limiting, and should be revised, along with the provision of a committed capital structure.

The tax code should be amended to provide for the deductibility by the company of dividend distributions to avoid double taxation of dividend income and to remove the disparate treatment between debt and equity financing.

A tax code amendment should be created for pass-through treatment of dividend income, investment income and realized capital gains without the 90% distribution requirement so that the gains and income are only taxed at the personal level when distributions are made.

State Regulation

The states should provide exemptions from state securities laws, except for anti-fraud purposes, for all offers and sales to accredited investors.

There should be federal preemption of all state securities regulation except (1) enforcement matters (i.e., state anti-fraud rules) and (2) broker-dealer regulation.

State securities laws should be preempted, or the SEC should train people at the state level to achieve greater regulatory uniformity.

The Commission and states should permit posting of an offering memorandum or prospectus on a web page that contains a prominently displayed statement either affirmatively identifying the states in which the offer is being made or identifying the states in which an offering is not being made. Such a posting shall not constitute an offer or a solicitation of an offer, provided the offering has been authorized for sale in every jurisdiction in which offers are intended to be made.

MISCELLANEOUS

The Forum's recommendations should be distributed at the Small Business Town Meetings.

We recommend that the SEC be held accountable for all activities and initiatives relative to the recommendations that come out of the Forum. We recommend a timely and concise reporting to maintain a level of communication in order to enforce/encourage enactment of recommendations and utilization of resources of its participants.

Invite to all future Forums all state and federal agencies that impact the capital formation process for small businesses, making specific attempts to have other SEC divisions, Capitol Hill staff members, and the IRS participate.

Encourage the participation in future Forums by more women and minority groups.

II. INTRODUCTION

The U. S. Securities and Exchange Commission hosts an annual forum that focuses on the capital formation concerns of small business as provided in the Small Business Investment Incentive Act of 1980. Thus, in each of the past fifteen years, the SEC Government-Business Forum on Small Business Capital Formation has been convened. A major purpose of the Forum is to provide a platform for small business to highlight perceived unnecessary impediments to the capital-raising process. Numerous recommendations have been developed at these Forums seeking legislative and regulatory change in the areas of taxation, securities regulation, financial services and state and federal assistance. Participants at the Forum typically are small business owners, venture capitalists, government officials, trade association representatives, academicians and advocates of small business. While a number of different formats have been tried over the years, a very effective one for purposes of the development of recommendations for governmental action has included the use of small interactive participant groups; and in recent years, the Forum has typically included this feature. The Fifteenth Annual Forum was held in Washington, D. C. on September 26 and 27, 1996.

The Forum is governed by an Executive Committee comprised of senior government officials and representatives of small business who have a strong

interest and expertise with the issues and capital-raising problems of small business. The Executive Committee organizes, plans and implements the Forum.

The topic areas of taxation, credit and securities again were selected as the focus of the Forum. The Executive Committee had determined that the format of the sessions would present in the mornings a variety of roundtable discussions, each devoted to one of the three targeted disciplines. Each roundtable would highlight current issues in its targeted topic area, and be moderated by a member of the Forum's Executive Committee, with a core staff of presenters and commentators comprised of several experts in the particular discipline. Because all of the roundtables would be offered concurrently, Forum participants had to select the roundtable discussion in which they wished to participate. As in prior years, time would be devoted to discussion in small interactive break-out groups in order to permit Forum participants sufficient opportunity to develop thoughtful recommendations. These groups were to be comprised only of participants who had attended a particular topic roundtable.

Welcoming remarks were offered by Brian J. Lane, Director of the Corporation Finance Division of the U. S. Securities and Exchange Commission. Jere W. Glover, the Chief Counsel for Advocacy, U. S. Small Business Administration then presented a report regarding the status of implementation of the recommendations from the 1995 White House Conference on Small Business. This report was followed by the scheduled roundtable discussions. The luncheon address was presented by Richard Y. Roberts, Chief Executive Officer of the Princeton Venture Research Group, who was introduced by SEC Commissioner Steven M. H. Wallman. Break-out sessions among the Forum participants were conducted throughout the afternoon.

The second day's session followed the same basic format. The luncheon address was offered by the Honorable Philip Lader, Administrator, U.S. Small Business Administration.

The Forum participant break-out sessions produced 67 recommendations, all of which were finally endorsed and are highlighted in the following section of this report.

While the U.S. Securities and Exchange Commission hosts this annual convocation of small business friends and advocates, and is pleased to serve as such, it in no way seeks to sponsor or influence any of the Forum's recommendations. While a number of these matters are of substantial interest to the Commission as an institution, it takes no position on any of the recommendations. The views in this report are those of the Forum participants.

III. RECOMMENDATIONS FROM THE WHITE HOUSE CONFERENCE

That the Forum reaffirm endorsement of Recommendation 14 of the 1995 White House Conference on Small Business Recommendations, as follows,

To increase the availability of growth capital to invest in small businesses, Congress should:

a) Further privatize the Small Business Investment Company (SBIC) program, now administered by the SBA, by creating a new, government sponsored, but privately managed, corporation named Venture Capital Marketing Association or "Vickie Mae" which would function similar to the Federal National Mortgage Association (Fannie Mae);

b) Extend the capital gains tax deferment currently afforded investments rolled into Specialized Small Business Investment Companies (SSBICs) to include investments in SBICs to encourage more investment in new SBICs;

c) Remove barriers to pension funds, foundations and endowments wishing to invest in SBICs and SSBICs; eliminate the "unrelated business taxable income" (UBTI) tax on all such activities; and

d) Reduce the minimum capital size requirements for establishing SBICs owned by regulated financial institutions, thereby encouraging them to provide equity to small businesses provided that no leverage is utilized by such SBICs until current minimum capitalization for leverage is achieved.

This recommendation, if implemented, would increase the availability of growth capital to small business which is a very desirable goal. It specifies a number of areas where governmental regulations could be developed or revised in order to increase not only access to, but also the availability of, capital for the use of small business.

As was adopted in the March 1996 Final Report of the SEC Government-Business Forum on Small Business Capital Formation, this year's forum reaffirms and believes that proposition 286 warrants further consideration:

286. The U. S. Small Business Administration is vital to the growth of small business in America. Efforts to make the SBA's programs more cost effective and efficient should be continued and encouraged. The SBA's "independent" agency role as the primary supporter of small business within the Federal Government should be enhanced by:

a) Elevation of the U. S. Small Business Administration to a congressionally approved cabinet level position.

b) Budget allocations to maintain, increase, and enhance the 7(a) Loan Guaranty Program.

c) Budget allocations to maintain, increase, and enhance the 504 Loan Program.

d) Budget allocations to make permanent the Small Business Development Center Program which provides business assistance to small businesses nationwide.

e) Permanent maintenance of the "independent role" of the U. S. Small Business Office of Advocacy.

f) All other SBA programs should be reviewed with substantial input from the private sector. Any programs deemed to be ineffective should be eliminated.

The continuing operation of the Small Business Administration and its programs is important to the small business community. The significance of the U. S. Small Business Administration and the programs it operates to small businesses in this country can not be underestimated. Serious efforts should be undertaken to preserve this governmental function and enhance its utility.

IV. TAXATION

A. Statement of the Issues

Tax policy can impose a heavy burden upon smaller businesses. Uncertainty as well as frequent changes in the rules further complicates the area for most small businesses that are already overburdened with demands upon time and resources. Tax policy also can be used in ways that encourage certain activities which could foster the successful operations of the smaller entrepreneur.

B. Recommendations

Preamble

Small business recognizes the rationale for taxes and understands the need to pay tax to support government. However, we are opposed to taxes that have the result of diminishing the capital that provides growth needs of small business to generate GDP and jobs. Simplified, fair, understandable taxes are necessary.

Any administrative action that burdens small business is counterproductive to profitability of business needed for continuance. We feel these recommendations target the source of these objectives and mil resolve many, but not all, of the current problems.

Primary Recommendations

Fundamental Tax Reform

It is the consensus of the Forum that current tax law and regulations promulgated thereunder unduly hinder the ability of small business to attract and maintain the capital necessary for formation and growth. It is for this reason that the Forum submits the following recommendations to promote fundamental tax reform and totally abolish the complicated present system. Congress should enact legislation that replaces the present system with a single comprehensive simple tax for individuals and businesses that eliminates double taxation. We recommend a system that encourages savings and is not difficult or costly to comply with.

Simplifying the federal tax structure will cause many benefits to all parties involved. Small businesses would reap its share of the benefits, if such a system could be implemented.

Social Security Fundamental Reform

We urge the Congress enact legislation to reaffirm the stability of the existing Social Security System and to guarantee the commitments for all current participants. In the interests of increasing capital formation in the U.S. and assuring a more productive national retirement system, we recommend that an optional system be designed to eliminate inter generational funding. This system would eventually replace the existing Social Security system.

Any uncertainty relating to the soundness of the nation's Social Security System has a negative impact upon economic matters, which hurts small businesses' ability to raise capital. The current system, which bases its effectiveness on the contributions of currently working persons, is inherently unstable and needs to be replaced.

Overall Capital Gains Reform

Congress should reinstate a 50% capital gains exclusion on sales of capital assets held more than one year.

Tax policy should be used to encourage investments in small businesses. The tax differential for capital gains encourages the investment of risk capital,

especially in small and development-stage companies. The suggested change would modernize our tax policy with respect to this important issue and make it more consistent with the policies of other industrialized countries. Importantly, if implemented, more monies would become available to finance the efforts of small business as a result of such changes.

Estate Tax Reform

Estate Taxes negatively impact small business in capital formation, job creation and business continuity; therefore, our Forum calls on Congress to repeal the Federal Estate and Gift Tax.

Federal estate taxes are graduated and run up to a maximum rate of 55 percent. The current estate tax exemption of $600,000 may be insufficient to cover the value of many family businesses. The overhang of this taxing system, and the gift tax system as well has a particularly harmful and negative effect upon the valuation of small businesses. Excluding the value of such businesses for purposes of calculating estate and gift tax could have an overall beneficial impact on the general economy.

Secondary Recommendations

Targeted Capital Gains Reform

Congress should enact a targeted capital gains law that promotes the long-term investment in qualified small businesses. This law should include the following provisions:

A) A capital gains exclusion of at least 50% of the regular capital gains tax rate for an investment in a qualified small business which should include all forms of business entities, including pass-throughs.

B) The exclusion should increase as the holding period increases to promote the concept of "Patient Capital".

C) A tax of not more than 10% (preferably zero tax) should be imposed on the sale of a majority interest in a qualified small business held for more than 15 years.

D) A deferral of the gain on the sale of an interest in a qualified small business if the proceeds are reinvested in another qualified small business within two years.

E) A qualified small business should be an active operating business.

Capital gains treatment under the federal tax laws needs to be reworked for the benefit of small business. The listed recommendations will go a long way to assist the capital raising abilities of small companies, making their investment much more attractive to the nation's investors.

Independent Contractor Reform

The definition of an independent contractor must be clarified. Congress should recognize the legitimacy of an independent contractor.

a) The 20-factor test is too subjective. The number of relevant factors should be narrowed with more definitive guidelines for implementation. Realistic and consistent guidelines should require one of four criteria plus a -written agreement. The criteria are (1) realization of profit or loss; (2) separate principal place of business; (3) making services available to the general public; or (4) paid on a commission basis.

(b) Safe-harbor provisions should be established that would protect the hiring business from the burdensome penalties currently being assessed by the IRS. De minimis rules based on dollars paid, hours worked, years in business, and/or specified closed-end projects should be established.

(c) The IRS should eliminate back taxes for misclassification when Form 1099's are filed and there is no evidence of fraud.

(d) Congress should specifically allow employers and independent contractors to provide joint technical training and to jointly utilize major specialized tools without jeopardy of reclassification of the independent contractor to employee status.

(e) Changes and implementation processes should be formulated by a joint committee of legislators and small business people.

The uncertainty that surrounds the classification of "employee" versus "independent contractor" needs to be eliminated. From the perspective of small business operators, this determination impacts the decision whether tax withholding is necessary and if improperly decided by the employer can lead to significant tax penalties to the business.

IRS Reform

To prevent excessive taxpayer expense and erosion of capital to small business, we recommend that a reform be instituted to hold the IRS accountable for its actions as a unified body at all levels. We recommend that a training program and a communication network be put into place which would ensure that all

levels of the agency operate in compliance with all laws and regulations that are in place such as the 1996 Small Business Regulatory Reform Fairness Act. The standard for this should be set that institutes a training and development relationship with taxpayers. "Punitive" penalties should not be unreasonable to the "offenses" they address. Congress should review the collection penalty rates named in Section 6656 of the Omnibus Budget Reconciliation Act of 1989 (Public Law 101-239).

We suggest that an independent agency be available at the election of the taxpayer as a mediator in instances where the taxpayer feels "unregulated" authority has been exercised. The agency would be empowered to resolve disputes. This would not be applicable in cases of prior offense taxpayers.

This recommendation would also include special provisions for an innocent party or to a sincere hardship case.

This recommendation relates to a general overhaul of the manner of collecting as well as the collector of the federal income tax. It is a thoughtful constructive criticism of the current system and if implemented would work greater efficiency which in turn would be beneficial to all taxpayers, including small businesses.

Qualified Pension Fund Reform

The Congress should modify current law to allow an individual to invest under current limits, his or her own self directed qualified pension or profit sharing plans in his or her own small business. These funds could be used as a direct investment or as collateral to obtain debt financing.

This recommendation would allow for additional funding opportunities for the small business, while reducing the individual's tax liability. Owner/operators should be allowed to invest through their retirement plans to take advantage of the future success of their business.

ERISA Reform

In order to create and preserve capital for small business and its employees, Congress shall reform ERISA so as to allow employers to design qualified employee plans to suit employers and employees goals and needs, including but not limited to liberalization of vesting schedules, repeal of top heavy restrictions and adoption of reasonably prudent investment policies.

Revision of ERISA standards and policies could help smaller businesses in their general operations as well as in the recruitment and retention of qualified personnel. Utilizing innovative compensatory systems is a particularly desirable

method for a company that needs to retain cash for its business to remain healthy and competitive.

Investment Reform

In order to enhance the attractiveness to investors of small business investment, Congress should authorize a new investment instrument known as the Small Business Participating Debenture •which could provide two components of "interest", a guaranteed portion at a stated rate, and a participation contingent upon an agreed share in issuer profits. The participating component of "interest" would be taxed to the investor as long term capital gain, but deductible by the issuer as interest. Investor losses would be deductible against ordinary income similar to Section 1244 stock.

The creation and recognition of this new security would eliminate double taxation of profits which would be a very desirable development for small businesses.

V. CREDIT

A. Statement of the Issues

Access to capital is a critical concern for small business. Regardless of its location in the development cycle, a small business is in need of funds for its continuing operation. Typically, debt financing plays a central role in this recurring struggle to stay competitive.

B. Recommendations

Congress should establish and implement a cost-benefit analysis method of evaluation, to review the loan programs and Business Assistance Programs of the SBA. This analysis should identify program costs and the ultimate benefits generated by these programs in terms of job creation and retention, tax revenues generated, and the economic impact on the local and national business environment.

The recommendation would provide helpful information regarding the effectiveness of SBA programs which in turn could be used to revamp unsuccessful programs, replacing them with ones that would serve the small business community more efficiently, saving the taxpayers money at the same time.

Congress should evaluate action to facilitate:

-- the investment by mutual funds and public and private investment funds into investment grade securities of securitized small business loans; and

-- examining credit enhancement mechanisms to further facilitate small business loan securitization by public and private resources.

All potential methods of freeing up additional moneys for lending and investment in small businesses need to be explored. The suggestions if implemented would be helpful in this regard.

A program should be developed by the SBA, the lending industry, the SEC and/or Congress that will further leverage the SBA secondary market by providing a mechanism for the pooled securitization of the unguaranteed portion of SBA loans.

The active secondary market in the guaranteed portion of SBA loans could be effectively complemented by such a market in the remaining part of such loans. While the risks are somewhat greater since the government guarantee does not attach, there should be greater confidence that the entire amount of such loans will ultimately be fully repaid. Enhancements could be offered as well. Development of such a market would make more capital available for the use of small businesses.

The SBA should continue to evaluate the nature and character of long term technical assistance provided by the Women's Business Development Programs, as well as the pre-qualification programs, in order to further preserve and enhance such programs.

Small businesses headed by women are a rapidly expanding group and important part of the nation's entrepreneurial system. These businesses face special problems in addition to the typical ones encountered by new companies. For this reason, the SBA established a special counseling and assistance program for businesses operated by women. This program is of great value and should be continued.

The SBA should continue to evaluate and expand upon the reach of and incentives for the SBA micro-loan program.

A micro-loan under the SBA Program seeks to make directly funded loans through intermediaries to very small businesses in economically-depressed areas of the country. The loans are short-term with fixed interest rates. The maximum loan is for $25,000. The program presents opportunities for low-income individuals who are otherwise unable to obtain private financing to fund

their small businesses. Increasing the maximum loan levels, especially through credit unions would benefit local communities. The numbers of qualified intermediary lending institutions should be increased.

The banking regulators should permit financial institutions to utilize credit scoring as a tool but not as the major consideration in loan lending. Credit scoring should not be used in a manner that results in racial discrimination. In this regard, area and zip codes, as well as any other information that may result in racial discrimination, should not be used as a determinant in credit scoring models.

Simplifying the manner in which loans will be made is a desirable objective from the perspective of small business. The use of credit scoring is not inherently discriminatory and could be a beneficial development in this regard and making more money available for lending and in a quicker timeframe.

Environmental lender liability concerns of lending institutions should not exist where such institutions have only taken a financial position in real estate related loans (i.e. either directly or as collateral) and not in a managerial/administrative capacity.

Action should be taken to insulate lenders from future liability in connection with environmental laws where their only connection with the problem is that they have lent money secured by the property in question. Uncertainty and concern about potential exposure is causing lenders to shy away from making many necessary loans to small businesses.

The SBA should examine the costs and benefits of using alternative rate structures (e.g. alternative to the prime rate stipulated in the law) as the index rate for alternative-rate loan arrangements. Alternative rates could include Treasury bill rates or other money market rates. Long negative cash flow amortization structures should also be examined, accordingly. In this regard, it should be noted that over the past several years, the prime rate has become more rigid in adjusting downward when market rates decline. Small business borrowers with adjustment-rate loans have not benefited from declines in the market rates. More flexible index rates may help.

Greater flexibility in debt payment obligations would be helpful to small business. While the many SBA loan programs provide borrowing opportunities, adjustment of interest rates as economic situations change should be accommodated for the benefit of small business borrowers.

The SBA's Business Information Center programs ("BIC's") should be maintained and enhanced. A data base of business assistance programs made available by the SBA and other federal agencies should be maintained at each BIC.

Entrepreneurial training programs should be fostered through these BIC's, providing business plan development and loan packaging training on an international and domestic level to potential business clients and lenders. Use of technology to maintain and disseminate information via the internet in conjunction with the SBA's web site should be encouraged at each of these centers.

All SBA educational programs and facilities should be continued and encouraged with the necessary funding. Small business needs every informational opportunity to learn of available sources of financing as well as how to maintain and grow their businesses.

In our ever changing global economy, international sales provide a significant growth opportunity to small businesses. New market penetration and profit potential benefit the entrepreneur while the government is encouraged by resulting employment growth, reinvested domestic earnings and improved balance of trade deficits. Unfortunately, banks, especially those lending with an asset based orientation, effectively exclude financing such international sales and/or resulting receivables. Efforts should be made to encourage or even mandate to some degree that banks avail themselves of the .several guarantee/insurance programs already in place by the Department of Commerce, SBA, Export-Import Bank and many of the states. Such programs generally provide financing for these export contracts/sales while leaving the banks' collateral and security intact.

Traditional lending sources should be informed about government programs that encourage their risk-taking in lending situations. This educational initiative may lead to the availability of more money for small business to succeed in their endeavors, particularly in the area of financing export sales.

VI. SECURITIES REGULATION

A. Statement of the Issues

Compliance with securities regulations may impose substantial costs upon issuers of securities. There is a geometric progression in the impact of such costs relative to the smallness of the issuer. Coordination of federal and state regulation continues to be needed and substantial relief from costs would flow from a more unified system of regulation.

B. Recommendations

Securities Act of 1933

The Commission should increase the transaction amount ceiling of Rule 504 to $5 million from $1 million.

The Commission's registration exemption, which requires essentially only compliance with the anti-fraud provisions of the federal securities laws, should be increased in amount from $1 million in a 12-month period to $5 million. Such an increase would reduce compliance burdens for small business.

The Commission and the states should implement a national "test the waters" provision for small business offerings.

"Test the waters" materials should be permitted for all Reg. D offerings.

Permitting issuers to gauge the potential investor interest in a possible securities offering before the preparation of costly compliance documents makes sense for the issuer and investor alike. Issuer costs can be substantially reduced with this process and investor protections are not compromised. This change would be useful for small business in both registered and exempt offerings.

The Commission should eliminate the general solicitation restriction for all Regulation D offerings.

The Commission should modernize its approach to exempted transactions by focusing on the purchase or sale portion of a transaction and remove the offer from regulatory requirements. This change would increase the utility of the exemptions for small business.

General solicitation and advertising for accredited investors should be permitted without restriction.

The prohibition on general solicitation for Rule 505 and 506 offerings should be relaxed in order to allow small businesses to find accredited investors. One possibility would be to create a safe harbor for communications with anyone that the offeror reasonably believes to be accredited.

This approach would constitute an intermediate step in revamping the "offer" analysis under the Commission's exemptive regulatory system. It would open up offerings to those highly sophisticated investors that the Commission has characterized as "accredited."

The intrastate exemption should be expanded to states contiguous to the principal place of business of the company.

To the extent possible, changing the focus of the so-called intrastate offering exemption from the state of incorporation to the state where the company transacts its principal business would make the provision far more useful than presently is the case. Expanding the scope further to include contiguous states to the state of principal operations would be even better from the vantage of the issuer. Since investors would be close enough to the location of the business, complete information about the operations could be easily obtained and verified.

The Commission should reexamine Rule 147 with a view towards modernizing the safe harbor, including the elimination or relaxation of the triple percentage tests and the addition of a substantial compliance provision modeled upon Rule 508.

Rule 147 provides definitional guidance to the intrastate offering exemption provided by section 3(a)(11) of the Securities Act. This exemption frequently fails because of the need to maintain the local character of the offering through both offers and sales and business. More comprehensive Commission guidance in Rule 147 would be helpful. The addition of the good faith and substantial compliance defense would be an effective guard against third party suits for inconsequential deviations from exemption terms.

A multi-jurisdictional regional offering exemption is a desirable expansion of the exemptive scheme from registration best achieved with the least effort by adopting a new Rule 504A with a dollar amount ceiling of $5 million, if the offering is authorized for sale in the states where the offers are intended to be made, with a required delivery of a disclosure document.

A new exemption should be considered by the Commission which would join the benefits of state regulation and review with an exemption requiring minimal federal oversight as is the case with Rule 504. By requiring development and distribution of an offering document which has been reviewed by securities regulators, the federal exemptive ceiling can be safely increased as proposed.

The Commission should adopt a new exemptive rule under Section 3(b) of the Securities Act permitting offers and sales of securities within regional areas. A regional area may be defined by an established market area, metropolitan area or a geographically limited area.

Issuers that are geographically located in proximity to state lines should be permitted to use the concepts underlying the intrastate exemption, even though investors may live on both sides of a state boundary line, due to the local natures of their businesses, and the familiarity local citizens have with their businesses.

By using its exemptive authority, the Commission could craft a rule which would cause this very desirable result.

The relationship between a monetary measure for "accreditation" of investors and actual sophistication as it relates to the investor's ability to fend for his or herself in financial matters (i.e., Does a monetary measure oversimplify and exclude those who are truly accredited, and able to fend for themselves?) should be reconsidered.

Under Commission tests of "accreditation," an investor meeting certain net worth or income levels is considered to be financially sophisticated. Natural persons with lower income or net worth levels may be equally, and in some cases, more sophisticated than these persons that currently qualify. The Commission should consider revisions to their definition in order to broaden its scope to capture all financially sophisticated investors.

All accredited and sophisticated investors should be permitted to see and invest in all private placements on a system after the moment of accreditation regardless of when the private placement is posted, and encourage states to adopt the same standard.

Under Commission staff interpretations, sophisticated and accredited investors have to have a preexisting business relationship with an issuer's agent before a private placement begins in order for that person to participate in the transaction; after commencement of the private placement a qualifying investor can review the offering but can not purchase. The purpose of this position is to discourage general solicitations in offerings that are required to be made in a non-public way. Because of development in electronic technologies, the emphasis should be placed upon the sophisticated nature of the purchaser rather than the time the investment was brought to their attention.

Sales only should be subject to regulation, rather than offers to sell securities.

Modern technology necessitates a fresh analysis of the way "offers" are regulated under the Commission's exemptive scheme, if they are to be subject to continuing regulation at all. One intermediate approach to the issue would be to permit free use of the electronic media to offer securities for sale and then to have strict requirements about the numbers and types of investors permitted to purchase in the offering.

Provide a safe harbor for forward looking statements included in offering documents of private placements and IPOs.

Financial forecasting is an important feature in investment analysis that is typically required by professional investors and lenders. The safe harbor recently enacted in the Private Securities Litigation Reform Act is not available for initial public offerings or for offerings (including private ones) by non-reporting companies. Because of this exclusion from the safe harbor, many issuers will not provide the information even though investors want it and will not buy the Company's securities without having it. This situation can have hurt an issuer's chances to raise capital.

There should be a bottom up review of the Securities Act and the Securities Exchange Act as they relate to the access to capital for small businesses. A task force should be created composed of staff of the SEC, NASAA, private industry and "gatekeepers" such as private attorneys and accountants to thoroughly reevaluate these Acts as they relate to small business.

The federal securities statutes need to be revisited to make more general accommodations for the capital-raising needs and problems of small business. The recommended task force would be a first step in acknowledging the problem and providing a map toward appropriate revisions that are consistent with investor protection.

In light of the new concept of "Company Registration" examine the possibility of small business 12(g) reporting category that facilitates reporting by small businesses and that would remove the trading restrictions of Rule 144, create a lower level of required disclosure for companies between $10 and $25 million, and move from quarterly to semiannual reports.

The idea of "company" registration for all reporting companies should be implemented by the Commission. This system will take advantage of the substantial amounts of company information already available to the market and investors and save issuers time and money by utilizing the Commission's information systems to keep the investor informed.

The Commission should adopt company-based registration but the ability of small issuers to utilize transaction-based registration should be retained as a parallel system for the purpose of protecting small issuers' access to the public capital markets.

Even with the implementation of "company" registration the maintenance of the present transactional system for small companies will aid in their marketing of their securities.

Securities Exchange Act of 1934

The regulators should provide a broker/dealer exemption for Finders. A Finder would be defined as a person who arranges for investors to acquire securities of a business.

Subjecting every intermediary who puts investors together with investment opportunity to the full scale regulation of the broker/dealer rules and regulations may deprive small businesses of important capital raising possibilities. A more thoughtful application of the requirements could result in a benefit to small business.

The Commission and the states should create/provide an exemption for Finders who are not registered broker/dealers. A Finder would be defined as a person who occasionally arranges for investors to acquire securities of a business: Non-broker/dealer Finders would not be subject to any qualifications criteria including, but not limited to, testing, bonding or reporting. The activities of a non-broker/dealer Finder may be circumscribed by the amount of compensation received or involvement with a specified number of transactions.

The exempted finder class could be based upon some de minimis level of activity, amount of compensation to be received or other objective criteria.

A limited class of broker dealer should be created that is enabled to raise capital for small business offerings, especially as it relates to using the Internet. This class would include a sub-set of broker dealers subject to a less rigorous series exam, be prohibited from handling money, and only permitted to do primary offerings.

The establishment of a category of broker/dealer specializing in the securities of small business issuers could benefit small businesses. Inducements to enter into the field such as lower net capital requirements and reporting provisions could be developed.

A new class of "Finder-Broker Dealers" should be created to develop a new professional class dedicated to locating "Angels" to provide capital to entrepreneurs. These individuals would be licensed to arrange "private placements" only.

Encouragement through regulatory accommodation or otherwise to increase the numbers of brokers interested and able to assist small business in their capital-raising ability should be explored.

A licensing requirement should be created for "financial public relations" people.

It is possible that provisions of the existing federal securities laws or regulations are being avoided by persons that need to be subjected to such regulations in the public interest and the protection of the nation's investors. The present situation may penalize the careful businessman interested in fully complying with the federal securities laws.

Registered broker-dealers should be allowed to share fees with non-registered broker-dealers provided that full disclosure of the fee-splitting arrangement is given to the customer.

Relaxation of restrictions on fee-splitting by broker/dealers should be considered.

Investment Company Act of 1940

The Commission should provide a method similar to that currently in place with "no action" and interpretative letter guidance whereby investment companies could rely upon the facts and circumstances utilized by others in securing Commission relief under section 6(c) of the '40 Act

The necessity of complying with detailed requirements to secure a Commission order for relief from Investment Company Act registration in appropriate cases should be revisited. To the extent some simplified system could be implemented, the Commission should take the steps to eliminate a needlessly time consuming and expensive process.

The "affiliated transactions" provision in section 57 of the '40 Act should be updated to provide flexibility.

This provision of the Investment Company Act makes it particularly difficult for business development companies to engage in the kind of venture capital financing that small businesses typically need. A broader relaxation should be considered where the transactions in question are designed to assist small businesses.

The possibility of facilitating investment by the average American investor in mutual funds designed for investments normally classified as "Venture Capital" should be examined in light of the constraints imposed by the Investment Company Act of 1940.

Changes should be made to the 1940 Act in order to more readily permit the investment by the average prudent investor in mutual funds dedicated to venture capital financing. The current regimen imposes too many barriers to the viable operation of such a targeted mutual fund.

A safe harbor should be established in the '40 Act for the "mark to market" evaluation of investment companies' portfolio of illiquid investments in small businesses to protect directors of such companies from possible liability by using the SBA's valuation policy as a guideline.

The Investment Company Act requirement of that fund boards determine the "fair value" of portfolio securities for which market quotations are not readily available discriminates against the illiquid securities typically issued by smaller companies. Using an established valuation guideline such as the one developed by the SBA should provide sufficient information to investors and consequently some protection for the investment company's directors from liability under the federal securities laws.

An exemption should be established from the '40 Act for a publicly-held venture fund where the fund is:

-- a non-leveraged SBIC regulated by the SBA with a minimum capitalization of $5 million;

-- an infra-state fund of $10 million (increase from the current $5 million);

-- comprised of qualified purchasers, defined as individuals with assets of $5 million or more, institutions with $25 million of more, and others as the SEC may define by regulation;

-- a state chartered economic development fund with 80% of the financing raised from accredited investors resident in the state;

-- 30 percent funded by 3 large institutional investors as defined by SBA regulation.

The recommended exemption from the provisions of the Investment Company Act provides adequate safeguards for investors and at the same time will significantly increase the financing options for small businesses through available sources of venture capital.

A number of these proposals were implemented by the enactment of the National Securities Markets Improvements Act of 1996 ("NSMIA") in October of 1996 after the development of the Forum recommendation.

The 200 percent asset coverage limitation imposed on BDCs by section 61(a)(l) of the '40 Act is too restrictive and should be raised or removed.

The BDC provisions of S-1815 regarding the issuance of stand alone options and rights should be adopted and implemented immediately. This will:

(a) broaden the investor base for BDCs by allowing institutional investors to stage-in their capital commitments, and

(b) enhance aftermarket trading and stockholder liquidity by balancing investment appeal between retail (individual) investors and institutions.

Present securities regulation should be modified to permit BDCs to make scheduled (binding) rights offerings to all existing stockholders during the 5 years after the IPO. This will:

(a) allow individual investors the option to "stage-in" their capital to BDCs similar to institutional investors, and

(b) enhance the individual investor's rate of return without the obligation to provide more capital.

A current yield to investors in BDCs should be provided by enacting a tax credit or tax deduction of 10% annually for the first 5 (five) years after the IPO of the BDC and recapture the tax impact by having the BDC pay a surtax of 10% of all capital gains when realized (until recapture). This will:

(a) improve the marketability of BDCs by enhancing the aftermarket trading of the BDC's stock and mitigating the NAV discount of newly formed BDCs, and

(b) establish permanent pools of risk capital that provide capital for job creation long after the tax revenue neutral impact is complete.

Exempt private fund managers (with more than $100 million of private equity under management) from the affiliate rules involving joint transactions with common portfolio companies among funds while retaining oversight by the BDC's independent directors. This will:

(a) encourage some of the most experienced professional venture fund managers to make their expertise and deal flow available to a broader range of retail and small institutional investors, and

(b) remove a major regulatory impediment to attracting the fund management talent necessary to bring major bracket underwriters and institutions to BDCs.

Remove the "liquidity penalty" of fund managers by enacting capital gains taxation treatment of incentive compensation regardless of the structure of the BDC (Corporate or partnership). This will:

(a) eliminate the tax penalty on fund managers who provide their investors with the BDC's benefits of liquidity, and

(b) align the long term return on investment interests of the BDC's managers with their investors.

The simplified compliance requirements of the Investment Company Act for business development companies need to be publicized by the Commission. The use of the abbreviated regulatory system has never reached its full potential in part because of the lack of knowledge about the program. The lack of vitality to the current BDC program could be remedied by a number of changes to the regulatory requirements for these companies subject to fewer restrictions under the 1940 Act than the "garden variety" investment company.

The subsequent adoption of NSMIA implemented a number of these recommendations to revise the applicable law for BDCs.

Subchapter M of the Tax Code imposes diversity tests on investment companies registered under the '40 Act that are too limiting, and should be revised, along with the provision of a committed capital structure.

The tax code should be amended to provide for the deducibility by the company of dividend distributions to avoid double taxation of dividend income and to remove the disparate treatment between debt and equity financing.

A tax code amendment should be created for pass-through treatment of dividend income, investment income and realized capital gains without the 90% distribution requirement so that the gains and income are only taxed at the personal level when distributions are made.

The effectiveness of present small business accommodations and any future developments in the 40 Act area are seriously impacted by the current federal tax laws. The recommended changes are necessary and will make such accommodations workable and fully effective.

State Regulation

The states should provide exemptions from state securities laws, except for anti-fraud purposes, for all offers and sales to accredited investors.

The development of a uniform "accredited investor" exemption from state securities regulation would be very helpful to small business capital formation and would have little impact upon the protection of investors. In the area of electronic matching services which are becoming popular, the current concern about violating state laws simply thorough publication of an offering even though limited to specific states where the offering has been qualified, could be eliminated by such a uniform exemption.

There should be federal preemption of all state securities regulation except (1) enforcement matters (i.e., state anti-fraud rules) and (2) broker-dealer regulation.

The federal system of registering and exempting securities and transactions from registration is sufficient in the public interest and to protect investors; the state presence in this activity is duplicative and unnecessary. Significant savings, cost and otherwise, would result if the states did not register securities and transactions involving securities sales.

State securities laws should be preempted, or the SEC should train people at the state level to achieve greater regulatory uniformity.

If preemption is not undertaken, then the Commission should be training the state regulators in order to enhance the uniformity of regulation.

The Commission and states should permit posting of an offering memorandum or prospectus on a web page that contains a prominently displayed statement either affirmatively identifying the states in which the offer is being made or identifying the states in -which an offering is not being made. Such a posting shall not constitute an offer or a solicitation of an offer, provided the offering has been authorized for sale in every jurisdiction in which offers are intended to be made.

A uniform system should be established which permits the use of the internet in securities offerings in states where authorized without running afoul of state laws where the offering has not been authorized, through a simple statement that the offering is being limited to certain specifically identified states.

VII. MISCELLANEOUS

The Forum's recommendations should be distributed at the Small Business Town Meetings.

We recommend that the SEC be held accountable for all activities and initiatives relative to the recommendations that come out of the Forum. We recommend a

timely and concise reporting to maintain a level of communication in order to enforce/encourage enactment of recommendations and utilization of resources of its participants.

Invite to all future Forums all state and federal agencies that impact the capital formation process for small businesses, making specific attempts to have other SEC divisions, Capitol Hill staff members, and the IRS participate.

Encourage the participation in future Forums by more women and minority groups.

These recommendations relate to the manner of conducting the annual Forum. The suggestions if implemented will make the Forum offer a broader-based participant group and should encourage the development of even more thoughtful recommendations.