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March 21, 2014

Elizabeth M. Murphy  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street NE  
Washington, DC 20549-1090

**SUBJECT: File Number S7-11-13 – Release 33-9497, Comments Related to Regulation A and BDCs**

Dear Ms. Murphy,

I am writing on behalf of Commonwealth Fund LLC (CF),<sup>1</sup> a community economic development organization dedicated to the establishment of a new type of Business Development Company (BDC) focused on economic development at a regional rather than national level. Our company is an outgrowth of Commonwealth Group,<sup>2</sup> a non-profit community economic development think tank led by myself and a number of CF colleagues.<sup>3</sup>

The SEC has requested input from interested parties to assist in answering questions that arose during preparation of the proposed Title IV rules with the proposed Tier 1 & Tier 2 offerings (hereinafter Regulation A or Reg A and Regulation A+ or Reg A+ and collectively Reg A/A+). Specifically, this letter will address questions 7 and 8 regarding the proposed Title IV rules. They are:

*7. Should we amend Regulation A to make BDCs eligible to rely on it? Why or why not? Would it raise particular concerns about investor protection? If so, please explain.*

*8. Would extension of Regulation A issuer eligibility to BDCs be inconsistent with the exemption's current prohibition on use by reporting companies? If so, should we limit the extension of Regulation A issuer eligibility to only non-Exchange Act reporting BDCs? If not, should we permit BDC ongoing reporting under the Exchange Act to satisfy their reporting obligations under Regulation A? If Regulation A eligibility were extended to BDCs, should other rules be amended to require additional disclosure about such issuers? If so, what specific additional disclosure should we require about BDCs?*

Given our focus on regional economic development via BDCs, we would like to submit the following recommendations to the SEC regarding the new rules related to Regulation A and Regulation A+ as they pertain to Business Development Companies (BDCs) addressed in the above questions and in footnotes 54, and 75-78.

We also intend to separately provide the Commission with additional comments related to BDCs used as regional development vehicles. They will provide information and recommendations that fall outside of the scope of the above questions, but pertain to the same general issues.

We believe that our recommendations will benefit all stakeholders, including the SEC itself.

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<sup>1</sup> <http://www.commonwealthfund.us>

<sup>2</sup> <http://www.commonwealthgroup.net>

<sup>3</sup> Team bios [http://www.commonwealthfund.us/index.php?option=com\\_content&view=article&id=7&Itemid=111](http://www.commonwealthfund.us/index.php?option=com_content&view=article&id=7&Itemid=111)

Our general and specific recommendations for this comment letter are enumerated below, followed by an analysis as to why we are making such recommendations, and what benefit we believe they will provide.

### **GENERAL RECOMMENDATION**

In response to the question “Should we amend Regulation A to make BDCs eligible to rely on it?”, we would recommend yes, but only for newly formed BDCs that are not already reporting companies, and in particular for those that are formed to serve a local region rather than a national constituency.

And since BDCs have mandates that already go beyond those of generic companies wishing to use Regulation A (such as the majority of the board of directors must be persons who are not “interested persons;” BDCs must publish their portfolio valuation policy and information on each investment; and they are required to make available “significant managerial assistance” to their portfolio companies) we feel that the investor public would already be more protected in comparison to investing in generic companies using Reg A, and that no additional investor protections would be needed.

### **SPECIFIC RECOMMENDATIONS**

1. Business Development Companies should be allowed to use Reg A & Reg A+ as a means of fundraising provided they are not already a reporting company. They should be allowed to use Reg A/A+ exempt offerings, until such time as they elect to fully register their securities and become reporting companies, whether exchange listed or not.
2. In addition to the disclosure requirements normally required of a BDC such as the valuation policy, the other reporting requirements for a BDC using Reg A/A+ offerings should be limited to those required of regular companies making Reg A/A+ offerings, until such time as the BDC elects to register its securities and become a full reporting company.

### **ANALYSIS OF THE RECOMMENDATIONS**

#### **Current Crop of BDCs**

Like Regulation A, BDCs have long been authorized but rarely used. We won't speculate why, but rather we will look at the current crop of BDCs and explore their prime characteristics and then define a new crop of BDCs that we anticipate will be emerging alongside the crowdfunding movement.

Of the approximate 40 major BDCs listed on Wall Street exchanges today,<sup>4</sup> less than five were listed on an exchange in 2000, indicating that only recently have BDCs begun to emerge even though they have been authorized since 1980. Even then, compared to mutual funds, their numbers are miniscule. And the vast majority of those currently listed have been formed by large financial institutions with BDC market caps that rarely fall below a billion dollars.

The bulk of those BDCs focus on middle market-sized business clients with almost none addressing the needs of small, Main Street companies. We think that is about to change and our organization is actively pursuing a business development strategy that is premised on a new variant of BDCs. We will be actively promoting this new kind of BDC so that local communities across the country might take advantage of what they can offer.

#### **New Crop of BDCs**

We expect the new crop of BDCs will largely be regional in nature, rather than national. That is, these BDCs will be formed to nurture local small businesses, supported by local investors. They will function like local venture capital/angel investment funds, only be backed by the community as a whole rather than

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<sup>4</sup> A listing of 40 BDCs <http://www.rysalisbury.com/bdc-journal>

a limited segment of more wealthy investors (i.e., a public venture capital company), as was contemplated by Congress with the original enabling legislation that authorized BDCs.

We expect that the equity crowdfunding community will likewise be predominantly regional in nature, where local investors support local businesses. Thus these two vehicles will serve similar constituents and are equally important. The difference is that equity crowdfunding will focus on individual companies, one at a time, whereas a regional BDC will provide a single conduit for investors to invest in a large number of local small businesses.

Therein lies a key element that could cause these regional BDCs to emerge as an attractive vehicle for nurturing local small businesses. By investing in many companies rather than one at a time, BDC investors spread their risk over a group of companies. The rationale here is similar to that used to justify investments in mutual funds.

There are a number of other reasons why regional BDCs may become very attractive to local investors, including:

1. BDC legislation has long been on the books and the small business community need not wait for the regulatory environment to be clarified. BDCs can be used today without delay.
2. Because BDCs are public companies, investments in them are inherently more liquid than individual small companies with just a few hundred or few thousand shareholders.
3. BDCs can be a good fit with a substantial portion of local small businesses, particularly established companies that need to raise larger amounts of capital (\$1 million+) than might be provided by crowdfunding, mom-and-pop Main Street businesses, micro-enterprises (1- or 2-person businesses) and small businesses for sale (especially by retiring baby boomers), in addition to those that might otherwise contemplate a standalone crowdfunding offering. BDCs can be used for all of those types of businesses and more.
4. New small businesses have a high failure rate. BDCs are not allowed to be passive investors. Congress mandated that BDCs make available “significant managerial assistance” to their portfolio companies. Small business failures can often be traced to a lack of mentoring and monitoring and thus the companies funded by a BDC not only get money but also potential business guidance and support, thereby substantially increasing their chances of survival.<sup>5</sup>

### **Why Regional BDCs Should Be Allowed to Use Reg A/A+**

While we strongly support the equity crowdfunding movement and applaud Congress, the SEC and the small business community for focusing on the critical need of getting funding to our nation’s small businesses, we feel that these new regionally centric BDCs can provide all stakeholders with a parallel solution to crowdfunding.

This brings us to the question of allowing BDCs to use Reg A/A+ offerings to fund their efforts.

We start with the premise that such BDCs would benefit from using Reg A/A+ for the same reasons as individual companies, i.e., it is a more cost effective way of making a public offering to local investors of freely tradable securities, without the costs and regulatory burdens that are required of a full reporting company. Add the “testing of the waters” option and the fact that there are no other good publicly funded

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<sup>5</sup> The Commission might consider making such managerial assistance mandatory for BDCs that use Reg A/A+ to raise public funds. That would especially be the case for startups that have a greater need for such oversight than do more mature businesses. Nonetheless, even mature small businesses can benefit from such outsider input. Commonwealth Fund intends to make the receipt of such oversight a condition of our making an investment in a company, for the benefit of all parties.

alternatives to Regulation A/A+ for a local investment company, and one can begin to see why we favor allowing regional BDCs to use those exemptions.

### **How That Might Work At The Local Level**

We can envision, for example, that a small local non-profit group, such as a business incubator, might be interested in helping nurture micro-enterprise entrepreneurial efforts in their community. These micro-enterprises are one and two person companies who may need just a few tens of thousands of dollars at most to establish and run their business. Regulation A would allow that non-profit to raise a maximum fund of \$5 million that could be used to fund hundreds of such local micro-enterprises. However, that would be out of the question if they had to conform to the regulatory requirements of a normal BDC. And the current crop of BDCs on Wall Street have already demonstrated that such investments are very far off their radar screens.

For efforts requiring larger funds to support other local small businesses needing bigger investments and/or loans than those required by micro-enterprises, we envision that Regulation A+ would provide an ideal vehicle for raising local funds from the general public for such local BDCs. The rationale for a regional BDC using Reg A+ to raise up to \$50 million would be similar to the reasons an individual company might want to do so – lower regulatory burden and cost to make a local public offering. Such local BDCs could grow and thrive without the regulatory burden of a full reporting company until such time as they push the upper boundaries that Regulation A+ would set on an annual basis. At that point they would have established sufficient critical mass to convert into a full reporting company and use normal BDC registration options to raise greater amounts of funds than those provided by Regulation A+.

### **Benefits to SEC and State Securities Regulators**

In addition to the above benefits to the investment community, especially at the local level, we believe that our recommendations will also benefit the SEC and state regulators.

- Our strategy of using BDCs as the conduit between the investing public and the recipient companies greatly simplifies oversight and regulatory compliance activities by virtue of the SEC having to work through just one company in order to address the needs of many companies. Investments by the BDC would all be done as private placements, eliminating the need for each individual company to file its own funding applications. Thus, by virtue of the one application done by the BDC, public funding of a substantial number of local small businesses will result without the additional regulatory burden for both the companies and the regulators.
- Investors, in turn, will realize substantial risk reduction as compared with investing directly in small companies. As in a mutual fund, a BDC investor's money is spread among many small companies, thus reducing exposure to potential bad actors. Of course, a BDC has superior vetting capabilities in the first place, and its portfolio companies have access to managerial assistance and oversight. All of these benefits aid regulators in their mission of investor protection.
- Further, it is noteworthy that individual companies normally have no restriction on the composition of their boards of directors. That is not so with a BDC. BDC regulations specify that a majority of the board of directors must be persons who are not "interested persons" of the BDC. Because these regional BDCs are local in nature, the likelihood is high that their board will be composed of local community leaders who have a vested interest in seeing that the local BDC serves the entire community and not just absentee owners. Thus the SEC and state regulators can have high confidence that the board will represent the needs of all local stakeholders – investors, the company, its employees and the community at large, thereby providing additional protections to all and helping the SEC and state regulators to fulfill their prime mandates.

**SUMMARY**

We feel that there is a natural affinity between Regulation A/A+ offerings and regional BDCs and that the SEC should approve the use of these exempt offerings by these regional BDCs, along with the above-recommended elements to ensure their optimum usage for the benefit of all stakeholders. Doing so would greatly enhance the ability of communities and local groups to serve the needs of a larger percentage of their local small businesses than crowdfunding alone could provide and to allow communities to bootstrap themselves back to economic health.

We thank the Commission for its efforts in this direction and for considering our recommendations. Commonwealth Fund is available to discuss the recommendations expressed in this letter and any issues they may raise. We look forward to working with the Staff and to making Reg A/A+ investing a success for investors, small businesses, entrepreneurs and the communities they support.

If you have any questions regarding this letter, please contact Michael Sauvante at (650) 641-1246 or at [REDACTED]

Respectfully submitted,



Michael Sauvante, Executive Director