



September 11, 2007

**Via Electronic Mail**

The Honorable Christopher Cox, Chairman  
U.S. Securities and Exchange Commission  
Attn: Nancy M. Morris, Secretary  
100 F Street, NE  
Washington, DC 20549  
Electronic Address: rule-comments@sec.gov

**Re: SEC File Number S7-15-07; Smaller Reporting Company Regulatory Relief and Simplification, Proposed Amendments to Regulation S-B**

Dear Chairman Cox:

The Office of Advocacy (Advocacy) of the U.S. Small Business Administration (SBA) respectfully submits this comment letter on the U.S. Securities and Exchange Commission's (SEC) proposed rule, *Smaller Reporting Company Regulatory Relief and Simplification*.<sup>1</sup>

Advocacy supports this proposal to expand the eligibility of the SEC's scaled disclosure and reporting requirements under Regulation S-B to smaller public companies with a public float of less than \$75 million. However, Advocacy is concerned that this proposal would eliminate the scaled disclosure forms under Regulation S-B and would require small businesses to utilize a modified version of the regular registration forms under Regulation S-X. Advocacy believes that this type of one-size-fits-all regulation may have unintended consequences such as extra legal and accounting costs. Instead of eliminating the widely used Regulation S-B framework, Advocacy recommends that the SEC consider regulatory alternatives such as a two-year phase-in period to measure the costs of the modified Regulation S-X forms to smaller public companies.

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<sup>1</sup> *Smaller Reporting Company Regulatory Relief and Simplification*, 72 Fed. Reg. 39670 (July 19, 2007).

## **I. The Office of Advocacy**

Congress established the Office of Advocacy in 1976 by Pub. L. 94-305 to represent the views and the interests of small business within the federal government. Advocacy is an independent office within SBA, so the views expressed by Advocacy do not necessarily reflect the views of the SBA or the Administration. The Regulatory Flexibility Act (RFA),<sup>2</sup> as amended by the Small Business Regulatory Enforcement Fairness Act (SBREFA),<sup>3</sup> gives small entities a voice in the rulemaking process. For all rules that are expected to have a significant economic impact on a substantial number of small entities, federal agencies are required by the RFA to assess the impact of the proposed rule on small business and to consider less burdensome alternatives.<sup>4</sup>

## **II. Background**

According to the Commission itself, the SEC has “a long history of scaling regulation,”<sup>5</sup> and has “made special efforts not to subject smaller companies and their investors to unduly burdensome federal securities regulation.”<sup>6</sup>

The SEC has two major categories of smaller companies for purposes of scaling securities regulations: “small business issuers” and “non-accelerated filers.”<sup>7</sup> Small business issuers are companies with both a public float and revenues of less than \$25 million. According to the SEC, of the 11,898 companies that filed annual reports under the Securities and Act of 1933 and the Securities Exchange Act of 1934 (Exchange Acts) in 2006, 3,749 had a public float of less than 25 million. Non-accelerated filers are companies with a public float of less than \$75 million. Of the 11,898 companies that filed annual reports under the Exchange Acts in 2006, 4,976 had a public float of less than \$75 million.<sup>8</sup>

Regulation S-B was created in 1992 as an alternative to the regular registration forms under Regulation S-X. Currently, only small business issuers with a public float and revenues of less than \$25 million are eligible to utilize Regulation S-B. One of the important provisions of Regulation S-B is Item 310, which requires less detailed financial statement requirements.<sup>9</sup> Regulation S-B “also contains a number of disclosure

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<sup>2</sup> *Regulatory Flexibility Act of 1980*, Pub. L. No. 96-354, 94 Stat. 1164 (1980) (codified as amended at 5 U.S.C. § 601 et seq.).

<sup>3</sup> *Small Business Regulatory Enforcement Fairness Act*, Pub. L. 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C. § 601 et seq.).

<sup>4</sup> 5 U.S.C. § 603.

<sup>5</sup> SEC Advisory Committee on Smaller Public Companies, Final Report of the SEC Advisory Committee on Smaller Public Companies 20 (Apr. 23, 2006) (*Advisory Committee Report*), available at: <http://www.sec.gov/info/smallbus/acspc.shtml>.

<sup>6</sup> 72 *Fed. Reg.* at 39671.

<sup>7</sup> *Id.*

<sup>8</sup> *Id.*

<sup>9</sup> *Id.* Regulation S-B allows small businesses to provide an audited balance sheet for the latest fiscal year only and audited statements of income cash flows, and changes in stockholders for each of the latest two fiscal years only. In comparison, Regulation S-X requires two fiscal years and audited statements of income, cash flows, and changes in stockholders equity for each of the latest three fiscal years.

requirements that are scaled to the characteristics of smaller companies, including requirements on executive compensation, related person transaction, and management discussion and analysis of financial condition and results or plan of operation.”<sup>10</sup>

In March 2005, the SEC chartered the Advisory Committee on Smaller Public Companies (Advisory Committee) to “assess the impact of the current regulatory system for smaller companies,”<sup>11</sup> and this rule stems from recommendations under this committee’s report.<sup>12</sup> This proposal has three primary components: (1) combining the two categories of small business issuers and non-accelerated filers into one category called “smaller reporting companies”; (2) expanding the eligibility for scaled disclosure and reporting requirements to most companies with a public float of less than \$75 million; and (3) maintaining the Regulation S-B disclosure requirements for smaller companies but requiring a modified version of the regular registration forms under Regulation S-X.<sup>13</sup>

### **III. Advocacy Supports New Small Reporting Company Definition and Extended Eligibility of Scaled Regulation under Regulation S-B**

#### *Smaller Public Company Definition*

Advocacy supports the SEC’s proposal to update the definition of a “smaller public company” and to extend the eligibility of scaled regulation under Regulation S-B, to reflect the changed market realities more accurately. This increased threshold will permit a broader range of smaller public companies to eligible for this regulatory relief. However, to change the definition or size standard of a small business for rulemaking purposes, the SEC must utilize the procedures outlined in the section 3(a)(2)(C)(i)-(ii) of the Small Business Act and the Small Business Administration’s regulations found in 13 CFR 121.903. These provisions essentially outline the information an agency needs to provide in order for SBA’s Administrator to approve a new size standard.<sup>14</sup>

#### *Advisory Committee Recommendation*

Advocacy supports the change in the definition of a “smaller public company” to companies with less than \$75 million in public float. However, Advocacy suggests that the SEC reconsider increasing the definition of “smaller public company” and expanding the eligibility for scaled regulation under Regulation S-B to companies with \$787 million in equity market capitalization, pursuant to the recommendation of this SEC’s own Advisory Committee. According to the Advisory Committee report, “our primary reason for recommending special scaled regulation for companies falling in the aggregate in the

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<sup>10</sup> *Id.*

<sup>11</sup> *Advisory Committee on Smaller Public Companies, Notice of Establishment*, 69 *Fed. Reg.* 76498 (Dec. 21, 2004).

<sup>12</sup> *Advisory Committee Report*, at 60.

<sup>13</sup> 72 *Fed. Reg.* at 39671.

<sup>14</sup> SBA Office of Advocacy, *A Guide for Government Agencies: How to Comply with the Regulatory Flexibility Act* 13 (May 2003) (*RFA Guide*), available at: <http://www.sba.gov/advo/laws/rfaguide.pdf>. This process involves consultation with the SBA’s Assistant Administrator from the Office of Size Standards.

lowest 6% of total U.S. equity market capitalization is that this cutoff assures the full benefits and protection of federal securities regulation for companies and investors in 94% of the total public U.S. equity capital markets.”<sup>15</sup>

### *RFA Requirements*

The Regulatory Flexibility Act (RFA) requires federal agencies like the SEC to complete small business regulatory flexibility analyses when an agency determines that a rule may have a significant economic impact on a substantial number of small entities.<sup>16</sup> The SEC must utilize the SBA small business size standards for this RFA analysis.<sup>17</sup> The SEC must update the small business size standard it utilizes for purposes of the RFA to conform with any new definition of a “smaller public company.” The SEC currently defines a small issuer as a company that had less than \$5 million in assets on the last day of its fiscal year.<sup>18</sup> For RFA analysis purposes, if an agency wants to use a different size standard, the agency may do so only after consultation with the Office of Advocacy and after the opportunity for public comment.<sup>19</sup>

## **IV. Advocacy Seeks Alternatives to Elimination of Regulation S-B Forms**

According to the SEC, “Regulation S-B was designed to provide small business issuers with a single source for their SEC disclosure requirements.”<sup>20</sup> Advocacy is pleased that the scaled disclosure benefits under Regulation S-B will be maintained in this proposal, but is concerned that the SEC is eliminating the Regulation S-B forms and requiring these smaller public companies to utilize a modified version of the regular registration forms under Regulation S-X.

### *Regulation S-B Forms Widely Utilized*

One of the reasons that the Advisory Committee provided for eliminating the Regulation S-B forms was input from a few individuals<sup>21</sup> and anecdotal reports,<sup>22</sup> citing “a lack of acceptance of S-B filers in the marketplace, a possible stigma with being a S-B filer, and the complexity for the SEC and public companies and their counsel of maintaining and staying abreast of two sets of disclosure rules that are substantially similar.”<sup>23</sup>

However, data shows that Regulation S-B forms are widely utilized by smaller public companies. The SEC estimates that there were approximately 1,028 registration statements filed on Form SB-2 and 24 registration statements filed on Form SB-1; and 3,504 annual reports filed on Form 10-KSB and 11,299 quarterly reports on Form 10-

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<sup>15</sup> *Advisory Committee Report*, at 16.

<sup>16</sup> 5 U.S.C. § 603.

<sup>17</sup> 5 U.S.C. § 601(3); *also see RFA Guide*, at 13.

<sup>18</sup> 17 C.F.R. 230.157.

<sup>19</sup> 5 U.S.C. § 601(3); *also see RFA Guide*, at 13.

<sup>20</sup> 72 *Fed. Reg.* at 39675.

<sup>21</sup> *Advisory Committee Report*, at 64.

<sup>22</sup> 72 *Fed. Reg.* at 39675.

<sup>23</sup> *Advisory Committee Report*, at 63-64.

QSB in 2006.<sup>24</sup> A SB-2 market research report noted that there were 153 more SB-2 registrations filed in 2006 than filed in 2005, representing a 17 percent one-year growth rate for this form.<sup>25</sup> This report notes that there have been 6,599 SB-2 registrations undertaken since 1995.<sup>26</sup>

The Advisory Committee report also stated that “we received input indicating that many securities lawyers are not familiar with Regulation S-B and therefore are hesitant to recommend that their clients use this alternative disclosure system.”<sup>27</sup> However, the SB-2 market research report cited 289 audit firms and 326 law firms that helped smaller public companies utilize these Regulation S-B forms in 2006.<sup>28</sup>

### *Advocacy Recommendations*

Advocacy believes that the proposed one-size-fits-all form may be too complicated and have unintended consequences for smaller public companies such as extra legal and accounting costs. In its Initial Regulatory Flexibility Analysis (IRFA) for this rule, the SEC notes that “rescinding all of the S-B forms would shift the location of disclosure requirements and would require that smaller reporting companies adopt their new formats in preparing their disclosure for Form S-1.”<sup>29</sup> However, the SEC does not provide an estimate for the costs that smaller public companies may incur based on the changes in these forms. Advocacy recommends that the SEC revise their IRFA to provide an estimation of the potential costs of this rulemaking to smaller public companies.

One of the most important provisions of the IRFA is the description of any significant alternatives to the proposed rule that accomplish the stated objectives of applicable statutes that minimize the rule’s economic impact on small entities.<sup>30</sup> Advocacy recommends that the SEC consider other alternatives to eliminating the Regulation S-B forms that will reduce the burden on small entities while still accomplishing the SEC’s regulatory objectives.

Advocacy supports a recommendation by the International Association of Small Broker Dealers and Advisors that the SEC provide a two-year phase-in period to allow users the choice of both frameworks to let the marketplace decide whether or not to utilize this modified form.<sup>31</sup> Advocacy also believes that the SEC should perform a technical review after these two years to assess the costs of these modified forms on smaller public

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<sup>24</sup> 72 *Fed. Reg.* at 39681.

<sup>25</sup> Brad Smith, General Partner, SME Capital Markets, *SB-2 Capital Market Research Report* (2007) (*SME Capital Markets Report*).

<sup>26</sup> *Id.*

<sup>27</sup> *Advisory Committee Report*, at 64.

<sup>28</sup> *SME Capital Markets Report*, at 1.

<sup>29</sup> 72 *Fed. Reg.* at 39688.

<sup>30</sup> 5 U.S.C. § 603(c).

<sup>31</sup> Comment letter from Peter J. Chepucavage, from the International Association of Small Broker Dealers and Advisors to the Securities and Exchange Commission (Sept. 4, 2007) *available at*: <http://www.sec.gov/comments/s7-15-07/s71507-3.htm>.

companies. After this technical review, the SEC can decide based on this data whether to implement the modified form or retain the two frameworks.

## **V. Regulatory Flexibility Act Determinations**

Advocacy also recommends that the SEC complete a required Small Business Compliance Guide for this rule. Under Section 212 of the Small Business Regulatory Enforcement Fairness Act (SBREFA), “for each rule or group of related rules for which an agency is required to prepare a final regulatory flexibility analysis...the agency shall publish one or more guides to assist small entities in complying with the rule.”<sup>32</sup> Please note that Section 212 was recently amended to require publication of compliance guides simultaneously with the final rule, or as soon as possible after publication.<sup>33</sup>

## **VI. Conclusion**

The SEC’s Advisory Committee on Smaller Public Companies was created “to assess the impact of the current regulatory system for smaller companies under the securities laws of the United States and make recommendations for changes.”<sup>34</sup> Advocacy supports this proposal to increase the definition of a smaller public company and the eligibility for Regulation S-B scaled regulations because it is a positive step that will help smaller public companies. Advocacy recommends a two-year phase-in period to measure the economic impact of eliminating the Regulation S-B forms on smaller public companies.

On a final note, Advocacy believes that the current regulatory environment after the imposition of Section 404 internal control reporting requirements has made it prohibitively expensive for any smaller public company to access the public markets. Although Advocacy supports the recent proposals by the SEC and the Public Company Accounting Oversight Board (PCAOB) to revise the implementing rules of Section 404, Advocacy believes that Section 404 will still impose large and disproportionate costs on small public companies.<sup>35</sup> Advocacy recommends that the SEC reconsider the Advisory Committee’s central recommendation, to provide an extension for small public companies to comply with Section 404.<sup>36</sup> This step will make the SEC’s other small business initiatives that much more meaningful.

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<sup>32</sup> *Small Business Regulatory Enforcement Fairness Act*, Pub. L. 104-121, Title II, 110 Stat. 857 (1996).

<sup>33</sup> *U.S. Troop Readiness, Veterans’ Care, Katrina Recovery, and Iraq Accountability Appropriations Act*, 2007, Pub. L. No. 110-28, Amendment 103 (2007).

<sup>34</sup> *Advisory Committee on Smaller Public Companies, Notice of Establishment*, 69 *Fed. Reg.* 76498 (Dec. 21, 2004).

<sup>35</sup> Comment letter from Thomas Sullivan and Janis Reyes to the Securities and Exchange Commission (Feb. 21, 2007), available at: [http://www.sba.gov/advo/laws/comments/sec07\\_0221.html](http://www.sba.gov/advo/laws/comments/sec07_0221.html).

<sup>36</sup> *Advisory Committee Report*, at 6.

Advocacy is pleased to forward the comments and concerns of small businesses. Please feel free to contact me or Janis Reyes at (202) 619-0312 (Janis.Reyes@sba.gov) if you have any questions or require additional information.

Sincerely,

//signed//

Thomas M. Sullivan  
Chief Counsel of Advocacy

//signed//

Janis C. Reyes  
Assistant Chief Counsel

cc:

The Honorable Susan E. Dudley, Administrator, Office of Information and Regulatory Affairs  
The Honorable Paul S. Atkins, Commissioner, U.S. Securities and Exchange Commission  
The Honorable Roel C. Campos, Commissioner, U.S. Securities and Exchange Commission  
The Honorable Kathleen L. Casey, Commissioner, U.S. Securities and Exchange Commission  
The Honorable Annette L. Nazareth, Commissioner, U.S. Securities and Exchange Commission  
Gerald J. Laporte, Chief, Office of Small Business Policy, U.S. Securities and Exchange Commission