America's Small Business Partners

March 8, 2007

Via E-Mail *(rule-comments@sec.gov)*

Securities and Exchange Commission
℅ Nancy M. Morris, Secretary
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: File Number S7-25-06

Dear SEC Commissioners:

This letter responds to the request for comments made in Release No. 33-8766; IA-2576 with respect to proposed additional protections for natural investors in pooled investment vehicles.

I write to you as President of the National Association of Small Business Investment Companies ("NASBIC"). NASBIC is the national trade association for Small Business Investment Companies ("SBICs"), representing an industry currently made up of 388 SBICs managing more than $20 billion in committed capital resources. In FY 2006, SBICs invested $2.9 billion in 2,121 U.S. small businesses that met the size and operational standards promulgated by the government. As you may know, SBICs are government-licensed, government-regulated, but privately managed venture capital funds whose statutory mission is to provide "private equity capital and long-term loan funds [to government-qualified small business concerns] which small-business concerns need for the sound financing of their business operations and for their growth, expansion, and modernization, and which are not available in adequate supply." (Small Business Investment Act of 1958, PL 85-699, as amended).

NASBIC's comments with respect to the proposed rules are as follows:

1. **SBICs should be specifically included in the class of venture capital funds to which any new, more restrictive definition of "Accredited Investor" would not apply.**

As proposed, the more restrictive definition of a "natural" accredited investor would not apply to venture capital funds. We support this exclusion. However, we also believe SBICs, as government-licensed and regulated venture mission entities, should be excluded by specific reference. The proposed definition of a venture capital fund is multi-faceted and, therefore, potentially subject to misinterpretation. Given that fact, it is possible that not all licensed SBICs would always be considered to qualify for all purposes under the proposed definition

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notwithstanding their statutory mission and the fact that prior to licensing all SBIC business plans, management teams, and private investors are subject to rigorous government review and approval. If the government has found that a fund meets the statutory and regulatory requirements for receiving an SBIC venture fund license, that finding should be binding in all cases for the purposes of the proposed rule.

2. **There is no need to increase the amounts specified for net worth and income criteria applicable to natural persons under the current Regulation D definition of accredited investor for venture capital funds, and certainly no need to change the definition for government regulated SBICs as a subset of venture capital funds.**

The importance of maintaining the current Regulation D accredited investor definition for SBICs cannot be overstated. In raising capital, SBICs often compete with private equity funds that raise considerably greater pools of money. The private capital of SBICs ranges from a statutory minimum of $5 million to usually not more than approximately $60 million, with $100 million a likely practical ceiling applicable to only a very few SBICs. Approximately 50% to 60% of that capital is raised from high net worth individuals; for individual funds the percentage can be higher. Because the field for raising private capital is already competitive, NASBIC is always concerned if the pool of private investors available to invest in SBICs is further limited—the certain impact the proposed definition would have if it were to apply to SBICs. The discussion accompanying the proposed rule estimates that the percent of U.S. households that would be able to make investments under the new definition would be 1.3%, 30.5% less than in 1982 and down from the estimated 8.47% of U.S. households elligible under the current definition of a natural accredited investor. If applied to the SBIC program, the 85% reduction in the pool of possible investors would have disastrous consequences on the ability of SBICs to raise private capital and would severely compromise the government's express intent for the SBIC program mission.

The proposal justifies a more restrictive definition of a natural person accredited investor by reference to inflation and the fact that financial products are more complex now than was the case when Regulation D was first issued in 1982. That is not the case with venture capital funds; the general structure of today's venture capital funds, at least insofar as risk and presentation of risk to non-management investors is concerned, is substantially unchanged from that in 1982. In fact, the disclosure of risks to potential investors is more comprehensive today than it was in 1982. Thus, there is no justification based on complexity or increased risk.

Neither should there be a change simply based on the impact of inflation. In part, the proposal uses inflation to set the more restrictive definition of accredited investor for the more complex pools it has targeted. In that the proposal is more sophisticated by recognizing that there are levels of risk in the broad range of private investment options available today and that not all levels of risk need be or should be treated alike. However, this begs the following questions: (a) what data supports the need to protect these wealthy individuals from themselves; and (b) what percentage of America's wealthy households have been victims of fraud from which the proposed more restrictive definition would offer protection? Without quantification of a real problem, adding more personal wealth restrictions on investment choices seems unreasonable. Looking at only one side of an equation can never yield a reasoned answer.

Finally, regarding levels of risk, we believe that investment in government-licensed and government-regulated SBICs should be accorded a lower risk profile than unregulated investment funds. While no venture capital or other private equity fund is without risk, certainly SBICs (100% of whose management teams are vetted prior to licensing and 100% of whose operations are subject to close regulation and examination) should be accorded a lower risk rating than others.

3. <u>Current commitments should be exempt from application of the restrictive definition.</u>

Notwithstanding the exclusion of venture capital funds, including SBICs, from the reach of the more restrictive definition of a natural accredited investor for other pooled investments, NASBIC believes the proposed more restrictive definition of an accredited investor should not apply to existing binding commitments executed by individuals in favor of investment funds. Investment funds such as SBICs draw down commitments from their investors as needed over a period of years. If an investor were to no longer qualify as an accredited investor and the fund could no longer draw upon the investor's unfunded capital commitment, there would be negative impact on the fund (including potential loss of its SBIC license), the fund's other investors, other funds with whom the fund may have participated in particular investments, the small businesses relying on the fund for capital support, and, of no small consequence itself, on SBA's financial exposure to the fund. We believe that once an investor qualifies as an accredited investor the fund should be able to continue to draw on the investor's commitment whether or not the investor remains an accredited investor, and SEC rules should not prohibit such draws. In this regard, tying the accredited investor test to a five-year adjustment for inflation would add to uncertainty and exacerbate the problem identified in this paragraph.

4. <u>Current rules with respect to "pool employees" are adequate.</u>

Absent any showing that there is a substantial problem that should be addressed, we do not believe there is any need to change current rules with respect to "pool employees" who are able to invest in private investment vehicles under certain exceptions to accredited investor requirements. Certainly that is our strong belief with respect to SBICs.

Thank you for your consideration of our views. Please contact me if you wish additional information or further clarification of our position.

Sincerely yours,

Lee W. Mercer
President