

need for attracting and holding able executives is so important to the future of the program. By reason of the inability of publicly owned SBICs to issue qualified stock options, the industry has already seen several able executives leave the SBIC program to go with other corporations that can legally issue stock options.

Section 17 of the Investment Company Act of 1940 empowers SEC to regulate affiliated transactions. Section 312 of the Small Business Investment Act of 1958 empowers SBA to regulate conflicts-of-interest. The two areas are essentially identical, and yet SEC insists on its right to police publicly owned companies while SBA's own regulations in this area are, in our opinion, entirely adequate to accomplish the purposes of both Agencies under their statutory authorities.

As you will note, the thrust of our application filed March 15, 1968 with SEC would transfer to SBA regulatory jurisdiction those provisions of the Investment Company Act of 1940 deemed applicable to SBICs and would thereafter exempt SBICs from the balance of the provisions of the Investment Company Act of 1940.

The overriding reason for the filing of the application was the urgent need of the SBIC industry to resolve the difficulties arising from the overlapping and sometimes conflicting rules of the two Agencies. We deem it essential to the intelligent management of an SBIC that it be answerable insofar as possible to one Agency, and in our view SBA, the Agency charged with the responsibility for licensing and generally regulating SBICs, is the Agency best qualified to assume full responsibility in this area.

We should like to stress that our application relates only to the Investment Company Act of 1940. It seeks no exemptions from the other federal securities laws. Specifically, we have no objection to the full disclosure requirements of the Securities Act of 1933 nor to the reporting requirements of the Securities Exchange Act of 1934 as they apply to SBICs.

The industry also seeks resolution of overlapping and contradictory regulations and rules in the tax area. Specifically, there are significant differences in the accounting rules applied to SBICs by SBA, the Internal Revenue Service and the SEC. Publicly owned companies are virtually obliged to keep three separate sets of books in order to report accurately to each of these three Agencies. It is our understanding that the National SBIC Advisory Council is directing its attention to this particular problem, and we are hopeful of obtaining some relief.

Another vexing problem in the tax area relates to the reserve for bad debts. By Revenue Ruling 64-48, IRS authorized SBICs to establish bad debt reserves equal to ten percent of outstanding loans. By its terms, Revenue Ruling 64-48 "applies for a period of ten years beginning with 1959." The Ruling then went on to state:

"When the ten-year period expires an SBIC's own loss experience will be used to determine the reasonableness of further additions to its reserves. After 1968 a new SBIC, or one that has not been in existence a sufficient number of years to provide adequate loss experience data for establishing reasonable bad debt reserves, will be permitted to use an average loss experience factor computed on an industry-wide basis until it has sufficient loss experience of its own."

Despite the foregoing language, neither IRS nor any other agency has yet developed "an average loss experience factor computed on an industry-wide basis . . ." Meanwhile, IRS has informed NASBIC that in its opinion, Revenue Ruling 64-48 will not be available to SBICs for tax years beginning in 1968. This leaves the industry in the position of not knowing what the IRS position will be hereafter with respect to SBIC bad debt reserves. A questionnaire is now in preparation to go to all Licensees to develop statistical data with reference to realized losses for all tax years from 1960 through 1968.

Meanwhile, NASBIC has been urging IRS to make permanent Revenue Ruling 64-48 or at least to extend it for a sufficient number of years to permit the industry to develop statistics relating to actual loss experience. IRS and the Treasury Department have indicated that they will not consider any extension or modification of Revenue Ruling 64-48 unless and until they receive statistical data on which to base a judgment with respect to such extension or modification.

Here again, the industry is hopeful that the new Advisory Council will be of some assistance in resolving this particular problem.

Another long pending problem in the tax area relates to the tax treatment of options received by lenders, including SBICs. IRS published proposed regulations on this subject in 1963, and we have been assured repeatedly that the final regulations would be forthcoming shortly. They have not been published as of this date, and the whole question of the tax treatment of options and warrants received by SBICs thus remains a very troublesome area for the industry.