

Section 15 of the 1940 Act, dealing with investment advisory contracts, finds its counterpart in SBA Reg. 107.809(a) (33 Fed. Reg. 332 (1968)), wherein SBA requires the filing of any contract entered into by the Licensee for investment advisory services and, where the SBIC is indebted to SBA, "reserves the right to approve the compensation of the investment adviser". The provisions in Section 15 of the 1940 Act dealing with underwriting contracts are in any event inapplicable to SBICs.

The thrust of Section 16 of the 1940 Act, governing changes in a company's board of directors, is implicit in SBA's statutory authority to license SBICs, incident to which it conducts investigations relating to the character and qualifications of proposed directors, and in its Reg. 107.1105(a) (33 Fed. Reg. 336 (1968)) requiring notification of changes in directors, specifying that such "changes shall be subject to SBA post-approval as a condition for the continuance of the license." Thus, Section 16 of the 1940 Act does not appear necessary to the proper regulation of SBICs.

Section 17 of the 1940 Act, relating to Transactions of Certain Affiliated Persons and Underwriters, presents particularly troublesome problems for SBICs registered under the 1940 Act. SBA's Reg. 107.3 (33 Fed. Reg. 327-28 (1968)), defining "Associate of a Licensee", when taken together with its Reg. 107.1004 (33 Fed. Reg. 334 (1968)), relating to Conflicts of Interest, deals adequately, in our view, with the matters encompassed within Section 17 of the 1940 Act. While the SBA regulations in this area are stringent, they are at least clear and susceptible of application to SBICs. The very nature of the operations of SBICs, involving as they do intimate and continuing association with their portfolio companies, constantly present the risk of inadvertently falling within the purview of Section 17 of the 1940 Act and the Commission's rules promulgated thereunder.

The Commission's Investment Company Act Release No. 5128 issued October 13, 1967 invited comments on the proposed revision of Rule 17d-1 under the 1940 Act. Attached hereto (Exhibit A) for incorporation herein by reference is the letter of November 21, 1967 from the President of NASBIC to the Commission commenting on the proposed revision. For the reasons outlined in said letter of November 21, 1967, we renew herewith our application for exemption for SBICs from the application of Section 17 of the 1940 Act.

Section 18 of the 1940 Act, titled Capital Structure, is generally speaking inapplicable to SBICs. In fact, Section 18(a)(1) is specifically made inapplicable to SBICs by Section 307(c) of the 1958 Act.

Section 18(a)(2) of the 1940 Act, dealing with permissible issues of preferred stock, finds its counterpart in SBA Reg. 107.1401 (33 Fed. Reg. 337 (1968)) which provides that where the capitalization of an SBIC is to consist of more than one class of stock, "the voting rights and other rights and remedies may not be inequitable or discriminatory, and may not unduly concentrate control or management of the Licensee through pyramiding, inequitable methods, or inequitable distribution." The same regulation further requires "Full disclosure of all voting rights and other rights and remedies of all classes of stock" to all shareholders prior to their purchase of stock.

Section 18(d) of the 1940 Act has been construed by the Commission to prohibit the issuance of stock options by registered investment companies. SBA Reg. 107.805 (33 Fed. Reg. 332 (1968)) specifically permits an SBIC to issue stock options to management and employees. We submit that SBICs now subject to the 1940 Act should likewise be permitted to issue stock options.

The success of the SBIC program will undoubtedly stand or fall on the capabilities of the management of the SBICs. With the present stress on more venture capital financing by SBICs and their continuing need to "plow back" earnings into additional investments and loans, the likelihood of SBICs having sufficient income to warrant salaries necessary to attract and hold qualified talents is not promising. Even if such income were available to pay higher salaries, the income tax applicable to such salaries would make them unattractive to the type of person ideally qualified to serve in an executive capacity with a venture capital institution such as an SBIC.

Stock options do serve as an attractive inducement to qualified managerial talent. This is attested to by the fact that the vast majority of companies traded on the national securities exchanges employ stock options extensively in compensating their executives.

Just within the past six months, two of the best executives in the SBIC industry, both employed by companies registered under the 1940 Act, left their SBICs to accept employment with other companies offering them stock options. In both instances, the executives made it clear that the availability of stock options outside the SBIC program was the deciding factor in their leaving their companies.