February 8th, 2023

The Honorable Patrick McHenry
Chairman
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

The Honorable Maxine Waters
Ranking Member
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

Re: February 8th Subcommittee on Capital Markets Hearing Entitled "Empowering Entrepreneurs: Removing Barriers to Capital Access for Small Businesses"

Dear Chairman McHenry and Ranking Member Waters:

The Small Business Investor Alliance ("SBIA") submits these comments for the February 8th hearing of the Capital Markets Subcommittee regarding proposals to increase access to capital for small businesses. The SBIA welcomes the Financial Services Committee's prioritization of economic growth and job creation initiatives for the 118th Congress.

SBIA is a national association that develops, supports, and advocates on behalf of policies that benefit investment funds that provide growth capital to small and mid-size businesses in the lower middle market, as well as the institutional investors that provide capital to these funds. Our membership consists of the advisers of traditional 3(c)(1) and 3(c)(7) private funds, small business investment companies ("SBICs"), rural business investment companies ("RBICs"), funds registered as business development companies ("BDCs") under the Investment Company Act of 1940, and the investors that invest in these funds including banks, family offices, and fund of funds.

Over the last decade, this Committee has led efforts to enact reforms to the securities laws that promote small business capital formation and investor access to growing companies. The 2012 Jumpstart Our Business Startups (JOBS) Act was a landmark piece of legislation that President Obama rightfully called a "gamechanger." Subsequent reforms that built upon the success of the JOBS Act originated in this Committee and were ultimately signed into law. Importantly, this work was done on a bipartisan basis and received broad support from businesses and investors alike.

Small businesses and their investor partners are facing an increasing number of threats to their ability to grow, hire new employees, and stay competitive. Reams of regulations, stubbornly high inflation, and the ability to hire qualified workers remain top concerns for small businesses. While these challenges exist for large companies, they are much more intense for small businesses and small business investors. A closely watched index of small business confidence

was recently at its lowest level since June 2022 and has remained below its 49-year average for the last twelve months.[1]

Unfortunately, the regulatory threats to small businesses and small business investors are growing and not subsiding. Over the last 18 months, the Securities and Exchange Commission (SEC) has pursued a regulatory agenda that is defined by compounding prescriptive and costly mandates that will affect all businesses, but small business in particular. Scale matters when enduring regulatory burdens. The government should not be making it more difficult for investors to provide capital to small businesses.

This SEC agenda includes, amongst other things, a proposal that would mandate burdensome reporting requirements and increase liability exposure for small private equity funds[2], a climate change disclosure proposal that would create unprecedented requirements for small private businesses that the SEC has no authority to regulate[3], and a proposal that would indirectly establish political environmental, social, and governance (ESG) standards for businesses receiving capital from business development companies (BDCs) or other investment funds.[4] SBIA has submitted comment letters to the SEC on these proposals (attached as addendum to this letter) to express our concerns that the SEC has not properly considered the cumulative impact these rules will have on capital formation and the willingness of smaller private equity funds and BDCs to invest in small businesses.

As the Financial Services Committee considers capital formation-related legislation in the coming weeks, SBIA wishes to raise the following issues and recommendations for consideration:

1. ***Access to Small Business Investor Capital Act (H.R. 5598 / S. 3961 from 117th Congress)*** This legislation would allow funds that invest in BDCs to disclose their acquired fund fees and expenses ("AFFE") as a footnote to their prospectus fee table. AFFE was adopted by the SEC in 2006 and was intended to provide investors with a clear picture of the costs associated with funds that invest in other funds. However, as applied to BDCs, AFFE provides a fundamentally misleading picture of the true cost of investing in BDCs, and effectively "double counts" the expenses of a BDC investment. BDCs are a critical source of capital for thousands of middle market businesses in the United States and are required by law to provide managerial assistance to their portfolio companies in order to help these businesses grow and prosper. The treatment of BDCs under AFFE has led to the exclusion of BDCs from certain indices which, in turn, has led to an outflow of institutional investor dollars in BDCs. This translates to a reduction in capital that BDCs can deploy to middle market and lower middle market businesses throughout the country. Permitting the disclosure of AFFE in a footnote (rather than in the actual fee table) will provide investors more accurate information in the fee table regarding costs and likely lead to an increased flow of institutional investment in BDCs.

[1] NFIB Small Business Optimism Index (Released January 10, 2023)
[2] Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews (February 9, 2022)
[3] The Enhancement and Standardization of Climate-Related Disclosures for Investors (March 21, 2022)
[4] Environmental, Social, and Governance Disclosures for Investment Advisers and Investment Companies (May 25, 2022)

SBIA has appreciated the opportunity to work closely with Democrats and Republicans on this legislation, and we are eager to work with all members to advance this bill during this Congress.

2. ***Raising the threshold for the private fund adviser exemption under Section 203(m) of the Investment Advisers Act.*** In 2010, Congress replaced the longstanding private fund exemption from SEC registration requirements with a set of narrower exemption criteria. Amongst this criteria, advisers to private funds with less than $150 million in assets under management (AUM) are exempt from full registration requirements. However, this $150 million AUM threshold was too low when it was written in 2010 and it has never been raised nor even indexed for inflation since, notwithstanding the growth of the economy and evolution of the private capital markets since 2010. Members of this Committee have previously recognized – on a bipartisan basis – that reporting requirements can place a disproportionate burden upon smaller funds. Accordingly, we support the draft legislation under consideration at this hearing that raises the current exemption threshold to at least $250 million in AUM and would require the SEC to update this level for inflation every five years.

3. ***Address the impact of the SEC's recently adopted investment adviser marketing rule on smaller funds.*** In 2020, the SEC adopted rules intended to ensure that marketing materials used by investment advisers and private funds provide the most accurate information possible to investors.[5] While well-intentioned, these rules have created compliance concerns for smaller private funds. Specifically, the performance disclosure requirements of the 2020 regulations do not properly consider advisers that use "European waterfall" arrangements, where performance and profit sharing are tied to an entire fund's performance (i.e. not just the performance of a single investment). Because many smaller funds use the European waterfall agreements, compliance with aspects of the marketing rule are in some cases impossible because they are being asked to report numbers that do not yet exist. "FAQ's" regarding the marketing rule released by the SEC in January 2023 left this problem uncorrected. SBIA believes that the SEC or Congress should provide some certainty for smaller funds regarding this issue. Honesty in marketing is a must, but reporting numbers that do not exist is not promoting honest disclosures.

4. ***Protect small, private businesses and BDC portfolio companies from the SEC climate and ESG proposals.*** As SBIA noted in recent comment letters, the SEC's climate change disclosure proposal would impose *de facto* political mandates upon private businesses that are vendors to or part of a public company's supply chain. These small private businesses – which the SEC has no authority to regulate – would be compelled to gather, standardize, and transmit information regarding Scope 3 emissions and other matters to reporting companies. The SEC failed to consider or analyze the impact such a requirement could have on these private businesses; if the SEC does not address this issue in the final climate disclosure rule then Congress must act. Small businesses are solely focused on survival and growth, without which ESG disclosures are meaningless.

[5] Investment Adviser Marketing (December 22, 2020)

Additionally, both the climate disclosure rule and proposed ESG reporting requirements for funds place unnecessary burdens upon BDCs, their portfolio companies, and their investors. BDCs would be required to collect certain information from their portfolio companies that may be impossible – or at least extremely costly – to collect. BDCs should not be subject to the SEC's climate disclosure proposal, and the SEC should consider existing BDC reporting obligations before deciding to impose new mandates on BDCs as part of the fund ESG disclosure initiative.

5. ***SEC overreach regarding Adviser Act recordkeeping requirements.*** Last week, SBIA joined with a number of other trade associations in a letter to the SEC expressing our concerns over the recent enforcement "sweep" of investment advisers regarding the use of text messages or messaging apps in the line of business. As the letter stated, we believe the SEC is basing this sweep – and potential future enforcement actions – on a fundamental misinterpretation of the Advisers Act and is overstepping its authority. This is another example of regulation-by-enforcement that is contrary to what Congress has prescribed under the Advisers Act.

SBIA appreciates the work of this Committee in holding today's hearings and looks forward to serving as a resource for members regarding issues that affect small business investment.

Sincerely,

Brett Palmer
President
Small Business Investor Alliance