



United States
General Accounting Office
Washington, D.C. 20548

Office of the General Counsel

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April 24, 1997

The Honorable Alfonse M. D'Amato
Chairman
The Honorable Paul S. Sarbanes
Ranking Minority Member
Committee on Banking, Housing, and Urban Affairs
United States Senate

The Honorable Thomas J. Bliley, Jr.
Chairman
The Honorable John D. Dingell
Ranking Minority Member
Committee on Commerce
House of Representatives

Subject: Securities and Exchange Commission: Privately Offered Investment
Companies

Pursuant to section 801(a)(2)(A) of title 5, United States Code, this is our report on major rules promulgated by the Securities and Exchange Commission (SEC), entitled "Privately Offered Investment Companies" (RIN: 3235-AH09). We received the rules on April 3, 1997. They were published in the Federal Register as final rules on April 9, 1997. 62 Fed. Reg. 17512.

The SEC is adopting the rules to implement the provisions of the National Securities Markets Improvement Act of 1996 (Act) as they apply to privately offered investment companies. The rules provide definitions necessary to effectuate the applicable provisions of the Act as well as providing certain interpretative provisions resulting from the changes made by the Act.

Enclosed is our assessment of the SEC's compliance with the procedural steps required by section 801(a)(1)(B)(i) through (iv) of title 5 with respect to the rules. Our review indicates that the SEC complied with the applicable requirements.

If you have any questions about this report, please contact Alan Zuckerman, Assistant General Counsel, at (202) 512-4586. The official responsible for GAO evaluation work relating to the Securities and Exchange Commission is Jean Stromberg, Director, Financial Institutions and Markets Issues. Ms. Stromberg can be reached at (202) 512-8678.

Robert P. Murphy
General Counsel

Enclosure

cc: The Honorable Jonathan G. Katz
Secretary
Securities and Exchange Commission

ANALYSIS UNDER 5 U.S.C. § 801(a)(1)(B)(i)-(iv) OF A MAJOR RULE
ISSUED BY
THE SECURITIES AND EXCHANGE COMMISSION
ENTITLED
"PRIVATELY OFFERED INVESTMENT COMPANIES"
(RIN: 3235-AH09)

(i) Cost-benefit analysis

The SEC's cost-benefit analysis consists of statements to the effect that the rules benefit privately offered funds and their investors in a number of ways by defining certain terms necessary to effectuate the new exclusion from regulation under the Act. The analysis states that the SEC does not believe the rules will impose any additional costs on privately offered funds but that these rules reduce unnecessary burdens without jeopardizing investor protection. The analysis also states that the Commission believes that the rules will promote efficiency, competition, and capital formation.

(ii) Agency actions relevant to the Regulatory Flexibility Act, 5 U.S.C. §§ 603-605, 607 and 609

Section 603: Initial Regulatory Flexibility Analysis

The SEC published a summary of the Initial Regulatory Flexibility Analysis (IRFA) in its Notice of Proposed Rulemaking, 61 Fed. Reg. 68100, December 26, 1996. The analysis includes information that describes the reasons for the proposed rules, their objectives, and the legal basis for them. The IRFA summary noted several alternatives considered by the Commission in connection with the proposed rules that might minimize the effect on small entities, but concluded that it would be inconsistent with the requirements of the Act to exempt small entities or to specify different requirements for small entities. The Commission states that it has determined that it is not feasible to further clarify, consolidate, or simplify the proposed rules for small entities.

Section 604: Final Regulatory Flexibility Analysis

The preamble to the final rules contain a summary of the Final Regulatory Flexibility Analysis (a copy of the full text of the analysis was furnished to our office). The analysis complies with the requirements of §604 and, in addition, states that there were no comments received with respect to the IRFA.

Among other things, the analysis states that the rules effectuate the Act's provisions that make possible the creation of small entities that are § 3(c)(7) funds.¹ These funds, privately offered investment companies that sell their securities solely to "qualified purchasers" owning or investing on a discretionary basis certain investments, are excluded from regulation under the Act. The rules also minimize certain compliance burdens imposed by the Investment Company Act on Section 3(c)(1) Funds² that are small entities,³ including as the analysis notes, Section 3(c)(1) Funds that wish to become Section 3(c)(7) Funds or invest in Section 3(c)(7) Funds as qualified purchasers. Section 3(c)(1) Funds range from small investment clubs to pools of sophisticated investors such as hedge funds and venture capital funds. The Commission estimates that there are 300 U.S. "venture capital pools" that are Section 3(c)(1) Funds that can be considered small entities and between 600 and 2,250 Section 3(c)(1) Hedge Funds that may be small entities.

In response to comments, the SEC adopted a number of changes from the proposed rules to minimize burdens on all privately offered funds, including those that are small entities by definition, particularly with respect to provisions that make the determination of a person's status as a qualified purchaser easier for Section 3(c)(7) Funds.

The analysis also addresses several alternatives considered by the Commission in connection with the proposed rules that might minimize the effect on small entities, but concluded that it would be inconsistent with the requirements of the Act to exempt small entities or to specify different requirements for small entities.

(iii) Agency actions relevant to sections 202-205 of the Unfunded Mandates Reform Act of 1995, 2 U.S.C. §§ 1532-1535

As an independent regulatory agency, the SEC is not subject to title II of the Unfunded Mandates Reform Act of 1995.

¹A new § 3(c)(7) was added to the Investment Company Act by the National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290 (1996).

²Section 3(c)(1) Funds are privately offered investment companies that have no more than 100 investors.

³Defined by the SEC as any privately offered fund with net assets of \$50 million or less at the end of its most recent fiscal year.

(iv) Other relevant information or requirements under acts and executive orders

Administrative Procedure Act, 5 U.S.C. §§ 551 et seq.

The rules were promulgated using the notice and comment procedures of 5 U.S.C. § 553. A notice of proposed rulemaking was published on December 26, 1996, 61 Fed. Reg. 68100, and comments were requested.

Paperwork Reduction Act, 44 U.S.C. §§ 3501-3520

The rules do not impose any new reporting, recordkeeping, or other compliance requirements that are subject to the Paperwork Reduction Act.

Statutory authorization for the rule

The rules were adopted under 15 U.S.C. 80a-2(a)(51(B),-6(c) and -37(a), 15 U.S.C. 80a-2 note and -3 note, 15 U.S.C. 80a-3(c)(1),-3(c)7, -6(c) and -37(a).

Executive Order No. 12866

The rule, promulgated by an independent regulatory agency, is not subject to the review requirements of Executive Order No. 12866.