TESTIMONY OF

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BEFORE THE
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STATEMENT OF JOAN SWEENEY

Madam Chairwoman, members of the Subcommittee, my name is Joan Sweeney and I am the Chief Operating Officer of Washington, D.C. - based Allied Capital Corporation, a publicly traded private equity investment fund. Today, I am very pleased to have the opportunity to discuss the effects that the federal securities laws have had on Allied Capital's ability to provide an alternative source of capital to illiquid private and illiquid public growing businesses which are so essential to the health of the nation's economy, and to share some of our specific experiences.

I wanted to speak to you today about the need to challenge and modernize the federal securities regulatory framework with the goal of enhancing the capital raising process while maintaining investor protection and encouraging investor participation in the capital markets. In particular, I want to focus on the capital raising process for growing small and middle-market businesses, an area in which the Securities and Exchange Commission and its hard-working staff (the "Staff") have made significant strides in the past few years (especially in adopting certain initiatives targeted at small business such as Regulation S-B and revising Rule 144).

The National Securities Markets Improvements Act of 1996, which provided numerous salutary modifications to the regulatory structure, noted that the purpose of the enactment was to "promote efficiency and capital formation" and to "promote more efficient management of mutual funds, protect investors, and provide more effective and less burdensome regulation." The promise of that noble purpose has, unfortunately, gone largely unfulfilled; as fundamental problems remain that inhibit the flow of capital to, and investor participation in, the small and middle-market business sector.

BACKGROUND AND EXPERIENCE

I want to specifically relate to the Committee my experience as an active market participant and as a funding source for small businesses. Allied Capital has been investing in small and growing businesses for over 40 years. We own and operate the oldest SBIC license issued by the SBA, and to date we have provided financing to thousands of small businesses nationwide. We provide both mezzanine debt and equity capital. Our portfolio of investments today is just shy of $2 billion, and our portfolio includes investments in 125 small and middle market companies. We have been able to make capital available to those businesses through a specialized business model known as a "business development company," or "BDC," which is regulated under the Investment Company Act of 1940 (the "1940 Act").

As a direct participant in the capital markets for the small and middle-market business, we clearly see the challenges faced by companies seeking to access growth capital. As a public company, we have direct experience in the cost and effort a public company must incur to access the capital markets and comply with the federal securities laws.

As an executive officer of Allied Capital, I have personally experienced the frustrations engendered by inefficient regulation. Although Allied Capital has been a successful conduit for bringing public investment dollars to small businesses, we have done so despite a regulatory regime that causes delays and inefficiencies that find no justification in the fundamental purpose underlying the federal securities laws – the protection of investors. As a former member of the

Staff of the SEC's Division of Enforcement, I understand and support fully the need for the Commission to be the "cop on the Street." However, to be an effective regulator the SEC must not only "police the marketplace," it must also facilitate the capital formation process. And under the current regime, the SEC's underpaid and overworked Staff has neither the legal authority nor the personnel to nimbly react to the changing financial landscape.

MODERNIZATION

I would like to address some of the over-arching issues that I believe Congress and the SEC need to be mindful of in order to look forward to a regulatory regime to serve public companies and investors as we embark into the 21st century.

<u>**Embracing technology and the Internet**</u>**:** In a world where finance is moving at the speed of light through the Internet and information is only a "click away," the manner in which we regulate the offer and sale of securities needs to be re-examined. The fact that information is not considered public for some purposes under the federal securities laws when it is presented on a company's website seems out of touch with the realities of the Millennium – especially when much of the disclosure regime already relies on on-line "EDGAR" filings to provide the public with information about registrants. Congress and the Staff need to think "outside the box," and perhaps outside the four corners of the prospectus. The concept of a virtual prospectus that incorporates a company's website communications needs to at least be considered. The time has come for a fresh look at what makes sense.

<u>Emphasis on "high value-add activity" and less emphasis on "low value-add activity":</u> Under the current, almost 70-year-old system, too much of the Commission's daily activities center around a regulatory protocol that provides for the review of registration statements associated with the initial or secondary offer of securities. I believe that this is a very cumbersome and low value-add service provided by an already overworked Staff. The law is the law, and the registrant, their lawyers, the registrant's underwriters, and their lawyers are responsible for and liable with respect to compliance with the law. Therefore, one has to question why a minimum 30-day review period, often undertaken by an unseasoned examiner, is necessary. The cost of such review can be extremely detrimental to the capital raising process, not only because of legal fees that can mount exponentially in response to questions often raised only from a lack of experience, but more seriously because of delay that can cause the registrant to miss a "market window." Time and resources are wasted on whether a registrant used the word "such" or "certain" too often.

The reality in the capital markets is that public deals are not sold off the registration statement. Although the Plain English initiative improved public disclosure documents, prospectuses are still not understood by many investors and frequently are not read. The vast majority of public securities are sold to mutual funds investing on behalf of the public, and the sophisticated mutual fund portfolio manager is researching far beyond the registration statement, and ironically using the Internet and the registrant's website. To further the irony, the individual investor is also using the registrant's website and Internet chat boards to get the "real plain English" scoop. Wouldn't it be more productive for the regulatory regime to focus its efforts on getting the information most efficiently through the channels that investors really use, rather than allocating limited Staff resources to spend countless hours reviewing an outdated registration form?

Challenge the usefulness of outdated rules and regulation through increased activity in providing exemptive orders and new rulemaking: Just as the entire registration statement process is outdated, there are many other specific examples where the current regulatory regime has not kept pace with the capital markets and is also very inconsistent in its application. Obviously, the examples most familiar to me are ones that specifically impact Allied Capital as a business development company, or BDC, and impede our ability to most efficiently provide capital to growing businesses. I am certain many of you are not even familiar with business development companies and their role in capital formation, and I believe that is directly attributable to an outdated and overly burdensome regulatory structure that is crying to be modernized.

BDCs were created by Congress in 1980 in the Small Business Investment Incentive Act. They are regulated pursuant to a customized regime under the 1940 Act. Congress' intent in creating the BDC structure was to encourage the flow of public capital to small, private companies. The BDC model as envisioned by Congress – public investment in small and growing companies – is sound and workable. BDCs, like Allied Capital, have been able to make a difference in the lives of small business owners throughout the country by providing them access to a source of capital – the public equity market – that otherwise would be unavailable.

However, despite their record of successfully providing small business financing, the BDC industry is still barely visible. The failure of the BDC structure is largely attributable to the fact that the regulatory regime dictated by the 1940 Act and related rules is overly restrictive and outdated. BDCs struggle under the yoke of a regulatory regime initiated over 60 years ago, which prevents BDCs from competing effectively in the capital markets. The result is that the BDC industry has failed to mature, and thus, deprived small businesses of access to capital.

For example, the current regulatory framework seriously limits the ability of BDCs to continually raise new equity in the public markets – the lifeblood of a BDC. The flexibility to regularly access those markets in a nimble and efficient manner, which has become an accepted way of life for seasoned public operating companies, has never been made available to BDCs. Unlike companies not regulated by the 1940 Act, BDCs are not allowed the benefit of an integrated disclosure system, and we cannot use the information provided to the public through our periodic Form 10-Ks and Form 10-Qs to update our shelf registration statement. This structure makes conducting a public offering for a BDC like Allied Capital unnecessarily cumbersome, time consuming and costly. A publicly-held bank, for example, simply because it is not subject to the 1940 Act, can enjoy the efficiency of integrated disclosure. We believe that our inability to use integrated disclosure is a mere oversight in the law and could be easily corrected by the Staff through no-action relief or rulemaking.

My experience has been that the Staff is hardworking and professional, but they are hamstrung by a lack of time to focus on the shortcomings of regulations developed for a wholly different market place that no longer exists. Allied Capital sought a “no-action” position from the Staff to allow integrated disclosure for our shelf registration statement by a letter initially submitted on July 8, 1998. After three years of waiting, last week we were told that under the current regulatory framework, the Staff could not grant the relief we were seeking. Rather, a request for rulemaking would have to be made, with no guarantee of immediate attention or a favorable result there either. Historically, rulemaking proceedings have been far more protracted – and costly – than no-action requests. The fact that we had to wait three years to learn that we not only don't have an answer to our question, but that we must now go back to the drawing board and pursue a different bureaucratic process to see if we might get an answer is a testament to a very inefficient regulatory regime.

Allied Capital is traded on the NYSE, our market capitalization is in excess of $2 billion, we actively maintain a very comprehensive website, we have 13 sell-side analysts that follow the performance of the company, we regularly provide information to the market through press releases, and we file Form 10-Q's quarterly and Form 10-K's annually. It seems incongruous in the Internet age, that we must formally update our shelf registration statement again each quarter to incorporate our financial information when this information is only a click away. BDC's should be allowed to have the same integrated disclosure systems that other operating 1934 Act registrants have. In fact, since a BDCs fundamental purpose is to provide access to capital, we believe that the regulatory regime should be focused on ways to encourage the formation of more BDCs in every way possible, not inhibit their growth. By modernizing the way they are regulated, Congress could truly make BDCs the source of public capital for small and growing businesses that was intended in the 1980 enabling legislation.

Resources are not being properly allocated to address creative solutions to capital raising such as enhancing the BDC structure. The Staff is extremely capable, but suffers from its inability to respond to market changes because of often misdirected time spent on implementing numerous low "value-add" or outdated regulations. The Staff needs to be given greater flexibility to allocate its time and resources to innovate and foster capital formation through thoughtful interpretive positions, exemptive orders and rulemaking. I am certain that if the Staff had the time to focus on enhancing capital formation as well as were empowered to address requests such as ours related to integrated disclosure, we would not have waited three years to find ourselves back at square one.

Modernizing the federal securities laws and the way they are administered will only strengthen our markets and make them even more attractive globally. The perpetuation of a system rife with expense and delay cannot be consistent with public policy or investor protection.

I believe that the changes that I have suggested would provide greater access to capital in a manner consistent with investor protection.

Thank you for the opportunity to present my views on this important subject.