U.S. SECURITIES AND EXCHANGE COMMISSION

TRANSCRIPT OF

FOURTH MEETING OF

ADVISORY COMMITTEE ON

SMALL AND EMERGING COMPANIES

100 F Street, N.E., Washington, D.C.

Multipurpose Room, LL-006

Friday, June 8, 2012
9:00 a.m.

PARTICIPANTS:

Advisory Committee Members:
Stephen M. Graham, Co-Chair
M. Christine Jacobs, Co-Chair
Heath Abshure
David Bochnowski
John J. Borer III
Dan Chace
Milton Chang
Joseph ("Leroy") Dennis
Sean Greene
Shannon Greene
Kara Jenny Goldstein
Richard Leza
Paul Maeder
Catherine V. Mott
Gregory Yadley

SEC Personnel:
Mary L. Schapiro, Chairman
Meredith Cross
Gregg Berman
David Blass
Lillian Brown
Kathleen Hanley
Steven Hearne

Tom Kim
Gerald Laporte
Lona Nallengara
Ignacio Sandoval
Jennifer Zepralka

Invited Speakers:
Dr. Jim Angel
Paul Dorfman
Dr. Jeffrey Harris
David Weild

MR. GRAHAM: Let's go ahead and get started. Before I give a couple of brief remarks, I want to confirm that we do indeed have a quorum. Are we going to take attendance? That's covered?

On behalf of Chris and myself, I thank you all for coming. I thank the Committee, thank the panelists, and of course we thank the SEC and all the support and hard work that they do in making time in their busy schedules to participate with us this morning, and this afternoon as well.

Much has occurred since our last meeting. Most notably the passage of the JOBS Act, and that certainly represented a significant step forward in the areas in which this Committee is focused. Namely greater access to capital and reduced regulatory burden as far as small and emerging companies are concerned.

Much as you've noticed, much of what we've recommended is reflected in the JOBS Act. We're now permitting general solicitation in the context of 506 offerings. We've increased the shareholders of record threshold under Section 12(g). We've increased the size of offerings submitted under Regulation A.

I think we all have to say that the JOBS Act is a good beginning but there remains still much work to do. For example, regarding IPOs, certainly we've changed the way IPOs are done in important ways. Whether it's having to do with the confidential filings that are now permitted, the opportunity to test the waters, or scaled disclosure. These things are clearly important, but a question that many have is, will these changes serve to increase the number of IPOs? Or are there structural issues in the market place which work against the kind of resurgence of small IPOs? Are there things we can do to create a more receptive environment? For example, should we create a middle market between existing public markets and the private markets-- something completely separate? There are a number of things to be considered in the area.

Certainly there is also the reduced regulatory burden on companies that fit within the definition of emerging growth company under the Act. There is scaled back disclosure with respect to compensation, MD&A, 404(b) and others. But what about those existing small companies that don't fit within the definition? It seems there should be a focus and appropriate decrease of the regulatory burden on those companies as well. As opposed to excluding certain companies because of an accident of birth, namely the date on which they became public companies.

With the help of the SEC staff and our panelists, we'll use today to recalibrate and consider some of the significant issues that relate to our work and helping with the background necessary to formulation of any future recommendations. The purpose of the meeting today is not to come up with any actual recommendations, but again to help us set the context-- set the stage for what will be the context we will find ourselves in when we're coming up with future recommendations.

That's again-- is going to have to do with focusing on where we are with respect to the JOBS Act, where we are with respect to structural issues in the market place, and, of course, the whole notion of scaled disclosure. At the end of the day, we'll discuss next steps and think about what we will do-- again, by way of coming up with our next set of recommendations.

As far as the way the morning will go, the way the day will go, I think everybody has a copy of the agenda. First, we'll hear from the SEC. Then we'll break. We'll hear from our panelists. They will talk about structural issues in the marketplace. Then everybody is on their own for lunch and we will reconvene at 2:00 and talk about scaled disclosure. That's all I have to say to kick this meeting off. I would like to ask our co-chair Chris Jacobs if she has anything she would like to add.

MS. JACOBS: Not too much. Thank you. Except to again thank you all for coming in and attending today.

Just to give you a little behind the scenes information, the staff here has been incredibly responsive to Stephen and I when we went to set up this meeting. We felt we needed to do a little review, maybe perhaps seeing how our recommendations coincided with what was passed with the JOBS Act. But then to be able to move on. So the presentations this afternoon I think are going to be exciting because it is the next step.

I think all of us being here today need to thank you, the staff, for arranging such in-depth speakers. I don't know that you all got an opportunity to look at the materials that have been provided, but they were in-depth and I think quite valuable to set the stage for our next round of discussions. Although we blinked and you all made it done, I think we need to say thank you very much for assembling today's speakers and the set of materials. With that, I'm finished. Thank you.

MR. GRAHAM: Thank you, Chris. Lona, do you want to introduce the staff and kind of kick off the first session?

MR. NALLENGARA: Sure. I don't think there are any other kind of administrative points, but I'll start off our first topic, which is a summary and a discussion of the JOBS Act. We have the staff members who are working on or involved with the rulemaking that will come from each of the parts of the JOBS Act. Six parts-- the five parts that have rulemaking plus the IPO on-ramp. I wanted to briefly describe your recommendations in each of the areas and the impact or the influence those recommendations had as part of the JOBS Act process. Each of the speakers will talk about the part of the JOBS Act that that they are speaking on, but also refer back to recommendations you made and put those recommendations in the context of the final legislation.

I'm not sure how many of you followed the January to April period of the Congressional process with the JOBS Act, but references to your recommendations related to general solicitation, and on 12(g), with respect to Regulation A, and the fact that you chose not to make a recommendation with respect to crowdfunding was referred to in media reports.

We were asked about your recommendations by Congressional staffers and your recommendations were referred to in statements made by members of Congress. I think we all think your recommendations have an impact. It was an independent voice of market participants, of companies, of investors who considered the same issues that were being discussed in Congress. I was happy to see that this Committee's recommendations were referred to and looked upon.

We will start with Title I of the JOBS Act. Title I is the IPO on-ramp, which I think at the last meeting you spent time discussing that. Jennifer will walk you through a summary of it and then some of the questions that companies and their advisers have been asking.

MS. ZEPRALKA: I'm not going to take up a lot of time talking about every provision because Steve talked about some of them. As you recall, emerging growth companies are a new class of companies created by Title I. It's companies with less than $1 billion in revenue for the last year and they can stay emerging companies for up to five years unless they go over $1 billion in revenue or become a large accelerated filer under our rules, which is $700 in million public float plus being a reporting company for a year, or issues more than $1 billion in non-convertible debt.

One of the big things that these companies get to do is submit confidential draft submissions for the IPO filing as long as they file publicly not later than 21 days before they do their roadshow. I'll come back to that in a minute. They get to do scaled disclosure, including two years of audited financials instead of three. Selected financial data, only for the same period that they did their financial statements, so 2 years usually rather than 5. They've scaled MD&A. Scaled exec compensation disclosure, exemptions from say on pay, say on golden parachute votes. When we do the rulemaking under Dodd-Frank for some of the other compensation disclosures for pay for performance ratios, they will not have to do those either. The big one they get exemptions from is Sarbanes-Oxley 404(b).

There are changes to the research and communications rules for emerging growth companies. We talked a lot about the research provisions last time we were together in February. There were some pretty big changes in what's permitted at the time of the emerging growth company's IPO. Including the underwriters in the IPO or another offering while they're still an emerging growth company. The underwriters can issue research reports before, during and after the offering. That research report is not an offer. That's a really big change.

Title I allows testing the waters. The emerging growth company and people acting on their behalf can communicate with QIBs and institutional accredited investors—QIBs are qualified institutional buyers, really big institutions-- to test the waters to see if there interest in their offering before or after they file their registration statement.

The key thing to note about Title I is that it's already effective. We didn't have to do any rulemaking to make any of this happen. The statute was self-effectuating. Because of that we needed to get ready to help companies use the new law right away. There were a lot of issues for us to deal with.

We created a whole team. Our disclosure operations group worked out the confidential submission process so that they were ready to go on the day that the President signed the bill. That doesn't sound like it was that big of a deal, but it was actually a big project for us to be able to take these confidential submissions because normally we take everything in EDGAR. When it goes on EDGAR, it is immediately public. We had to find a way to make that work.

For a while, we were taking those submissions only in paper or on a CD that had to be sent in to us. In early May, we announced that we had a secure email set up so that now companies can email those submissions in to us, which makes everyone's life easier. We received two confidential submissions within a couple hours of the bill being signed. A few people were ready to go right away. Since then, we've had about 30 new filings or so-- 30, 32-- under this process. Then outside of confidential submissions, pretty quickly right after enactment, within a few weeks, we had several sets of practical guidance that we put together and posted on the web site about Title I. We were getting lots of questions from companies and their advisors about how to make things work, what the language of the statute meant. We sent you, in your background materials, the links to all those FAQs, if you've had a chance to look through them.

Our general approach has been to try to be really practical about this guidance that we've been issuing, trying to make the statute work for companies, not throwing up roadblocks. If there was language in the statute that could be read in more than one way, we tried to be really practical about it and make it work and be consistent with Congressional intent.

For example, there's some language in the Act that could be read to say that an emerging growth company would have to provide five years of selected financial data in its IPO registration statement. Then in anything else after that, they could go to two years of selected financial data, which really wouldn't make much sense. We've put out an interp that we think the intent of this was that they could have the limited selected financial data in their IPO because they're doing two years of audited financials. Things like that.

We provided guidance on how and when companies can determine whether they're an emerging growth company. We gave guidance on how to calculate the $1 billion of non-convertible debt. That's one of the tests that knocks you out.

One interesting one we gave is guidance on testing the waters and road shows. I mentioned that provision before, that companies can go out and test the waters as long as they file their registration statement 21 days before the road show. Not every company does a road show, or a traditional road show. This could get you tangled up in what you're doing… talking to investors…is it actually a road show?

The definition of road show under our existing rules was very broad. We put out some guidance saying that we would treat this pragmatically. Testing the waters is not a road show.

But if the emerging growth company is not going out and doing a traditional road show, which is what everybody thinks of as a road show, then they need to get their actual registration statement on file 21 days before they want to go effective or before they start talking to people who are not qualified institutional buyers or institutional accredited investors.

There will still be a lot more questions and things that we'll need to do around Title I. It's too early to tell how some of the issues that we talked about in February will play out. On research, we don't know yet if underwriters are going to want to take advantage of the research provisions. We've heard anecdotally that some underwriters are not interested in doing research around an IPO. Others may be interested. We'll just have to see how that plays out. Of course, that's one thing we'd love to hear your input on and where you think the market's going to go, whether you think people are going to take advantage of these provisions.

There are two studies under Title I that are tied into what we are doing today. One is on decimalization, tick size. Within 90 days after the law was passed, we are supposed to study decimalization and the impact it has had on IPOs, and submit a report to Congress. The team working on the study is going to be here for the next session and is really looking forward to hearing the discussions.

The other study is on Regulation S-K. Within 180 days, we're supposed to review the registration requirements of Regulation S-K. S-K doesn't really have registration requirements, it has disclosure requirements, so that's what we're focusing on. I think that this afternoon's discussion of scaling will help inform what we're thinking about as we're working on that. So that's Title I.

MR. NALLENGARA: I'd be interested, for those Committee members who are closer to this, the changes in Title I to the IPO process, Steve, John, Greg, in your practice, have you seen changes? John, have you considered research and how you're going to react to those changes?

MR. BORER: Well, there's been a lot of discussion internally, and amongst my competitive brethren out there, at all levels of the food chain. Certain people have been willing to go on the record and certain people haven't. I know internally, with respect to our own firm, we've been cautious with respect to how we go out to the market on this, for a couple reasons.

One, it seems pretty clear that there's a lot of ambiguity in here as to how FINRA specifically feels about various of these provisions, and specifically with respect to the research analyst involvement. There are several tiers here.

First of all, as I understand it, the firms subject to the Global Settlement, irrespective of this legislation, are still subject to a court settlement that would have to be revised in order for them to be able to go and do this.

Now to the extent that those firms are the ones that are principally involved in leading the transactions, the guidance I've had from various of these bulge firms is anyone in the transaction as a co-manager with us will be subject to having an understanding with us as to how those things will be taking place, or else, because those firms are the ones that decide who's on the covers with them on these transactions. There's a lot of deference as to how those slots are allocated. I think that's going to be one thing, and how they behave I think is going to drive a lot of the rest.

With respect to the firms that aren't subject to the Global Settlement and on down the tiers, a lot of caution is being observed with respect to how FINRA is going to guide us on this. And in spite of the fact that the legislation says that SEC or these SROs will not, they control our business in so many other respects that we certainly have to appreciate their opinion as to how things will work.

Down the slot, the structure that's been created since Global Settlement and 2711 has created an environment within securities firms that analysts are walled off very carefully from banking. There are no lines of communications, other than through very strict chaperoning and other things that take place, even for those of us who are not members, or parties to the Global Settlement. That is not something that we can just flip a switch on.

Everything from how analysts behave every day, what they have to certify in their reports and those types of things, how communications take place. Then as a practical matter, if we are all of a sudden going to be asking them, in some cases perhaps requiring them as part of their job description, to do certain things, without being able to alter their incentives, then I think it's problematic, vis-à-vis asking anyone to take on substantial additional job reputational and professional responsibilities without being able to appropriately reflect that in their compensation.

This is something that I believe was not dealt with in anything that I've seen in the legislation. I haven't seen any rulemaking around this yet. But the grid, in fact, that's used-- I'm on the banking side of the wall, but it's used within firms, can't involve how they've done with respect to their performance on research around IPOs and offerings.

To the extent that they're being asked to take on more duties, responsibilities, obligations and reputational risk, without any enhancement in their compensation, is problematic.

Those are all up. I'm not answering much, but that's sort of the anecdotal things that I think are floating around out there.

MR. NALLENGARA: Putting aside how FINRA or the Global Settlement may shake out in, as the framework of what you can, what research can be issued and what a research analyst can do? The principle behind what the changes in Title I are, do you see that as being something that would benefit the smaller company considering an IPO, that they may not have had access to prior to the JOBS Act?

MR. BORER: Yes. I think the intent here to provide more information in a professional fashion to investors, including forward-looking projections coming from outside the company I think is a benefit to all investors. It has to be professionally administered, all the other regulations and things with respect to certification and a true, sincere belief in what they're saying and those types of things are already in place. I think the system, as it exists over in the U.K. with respect to how research ahead of IPOs will be published by brokers over there involved in the transactions is quite helpful. I guess that answers your question.

MR. BLASS: Lona, do you mind if I weigh in on one thing? I would be remiss. I'm David Blass of the Chief Counsel’s Office in Trading and Markets. I would be remiss not to mention that we are working on FAQs to address some of the ambiguities that you rightly note about the treatment of research analysts in the context of the JOBS Act amendment. We're hoping to put some staff guidance out to address many of those questions, including the application of the Global Settlement, how we view the JOBS Act amendment that permits research analysts to be physically present at meetings with management. Not necessarily addressing, though, the content requirements of discussions at those meetings.

We're working on those, we have to get those out in the near term. Sorry to put a target on my back, actually, with that, but I did feel we should mention that.

MR. NALLENGARA: Greg, please.

MR. YADLEY: I haven't really seen too much difference yet, probably for three reasons beyond just what John said of questions.

One is just the cost of gearing up to do a public offering that may not result in actually raising any money is a barrier. That can be breached by having underwriters who are interested in helping, who believe that there are investors out there and haven't seen a lot of activity. People have not been calling up saying, hey, we're now willing to do a $30 million IPO.

Then third, questions about the costs and benefits of being public now that people know that the threshold for having to be pubic is a little higher. I think they're trying to work through those. This is not a negative reaction. I think it's just, wow, there's a lot going on, it's pretty complicated. What's really different?

And without investment bankers sort of stepping up and saying, well, we think we can take advantage of this, I think it will be sort of a slow ramp up.

MR. NALLENGARA: I'm using this as an information gathering exercise for all of us. But has anyone had any experience with the testing the waters provisions? Any clients used it or considered using it? How have they done it? No?

Probably next meeting, I'm sure there will be lots of responses.

MR. GRAHAM: Again, Lona, I think clearly these provisions that relate to confidential filings and testing the waters are very important and they're meaningful. And we have had clients that have certainly taken advantage of the confidential filing provisions. As far as testing the waters is concerned, we all know what that means and we all know it kind of simplifies that aspect of the process.

Those things are important. They're being recognized. People are focusing on them and if they are not currently taking advantage, at least it's something that's on the table.

Again, you wonder to what extent, and we'll kind of get into what extent those kinds of provisions will kind of prompt someone to do an IPO that otherwise wouldn't be considering one. It will take someone who looks at the process, looks at the system, looks at the cost and says, I'm not going to be a public company.

Just because of those kinds of provisions, I'm not sure to what extent that's going to affect those kinds of decisions.

MR. MAEDER: We actually have two companies right now. One that decided to do the test the waters, be quiet, and the other one that's come completely out. I think the latter decided they were 100 yards from the edge of Niagara Falls, they're going public come hell or high water, and they're sure they're going to get support. The other folks weren't sure how much support they'd get so they're taking advantage of it. I'll have the full report for you next meeting.

MR. NALLENGARA: Let's move to Title II. Before I do that, I was remiss and I didn't give our disclaimer. Unfortunately for Jennifer, she's spoken and so she's in trouble.

[Laughter.]

MR. NALLENGARA: But anything I or any other staff members say are our own views and don't necessarily represent the views of the Commission or the staff. With that, I'll turn it to Tom Kim who is the Chief Counsel and Associate Director in the Division of Corporation Finance. He'll talk to us about Title II, which is the provision relating to general solicitation.

MR. KIM: Thanks, Lona.

Well, as we all know, Title II directs the SEC to amend Rule 506 of Regulation D to eliminate the ban on general solicitation, so long as sales are made only to accredited investors. And Title II also directs the SEC to adopt rules that will require the issuer to take reasonable steps to verify that the purchasers are accredited investors using such methods as determined by the Commission.

The other part of Title II directs the SEC to review Rule 144A to provide that securities sold pursuant to that resale exemption may be offered to persons other than qualified institutional buyers, including by means of general solicitation provided that the securities are sold only to the persons that the seller and any person acting on the seller's behalf reasonably believes is a QIB.

The key threshold, the key issue for us in doing this rulemaking, which we are required to do within 90 days, which is actually July 4, is not so much eliminating the ban, we know how to do that. It's really the part about taking reasonable steps to verify whether somebody is an accredited investor using such methods as determined by the Commission. We have to think about what those words mean in the context of the statute.

In helping us think about them, we have reviewed the comment letters, and they run the gambit from people saying, just accept the status quo and just say that the status quo today is fine. There are others who want us to be very prescriptive in how we require issuers to take reasonable steps and the methods that they use to verify whether somebody is or is not an accredited investor.

We are thinking about all those letters and thinking through ourselves how best to implement this and in a practical way. That is to come and that's very much on our plate right now.

I will say just as a general observation, in 2010 our staff reviewed Form Ds, and we studied the Form Ds and we have estimated that in 2010, over $900 billion of securities were offered pursuant to Rule 506, what we now call the old Rule 506. And a little over $1 trillion in securities were sold pursuant to registered offerings.

I would say that, right now, at least in 2010, when 506 had the ban on general solicitation, it's basically 55/45. When you think about the dramatically different liability schemes between registered offerings on the one hand and Rule 506 offerings on the other, I think however the rule comes out when the Commission adopts it, I would anticipate that the effects would be quite significant in the sense that it would be much more attractive for issuers to do 506 offerings now that they are able to use general solicitation.

I think from basic cost benefits standpoint, when you eliminate the ban on general solicitation, what does that mean? I think it means that the cost of capital could conceivably go down because it will be easier for issuers to access a wider range of investors, and perhaps those investors would be competing with each other to be able to invest in an issuer's offering.

On the other hand, it will be easier for people to commit fraud if they want to. I think really the focus is going to be on the Internet, because that obviously is the low-cost way for issuers and others to communicate with the public. Even after we do the rulemaking, we will be monitoring the space because we'll be very anxious to see how, in fact, these developments play out, because we do anticipate that the private offering market will be increased as a result of this rule.

That's really all I have to say about Title II. We're happy to take suggestions or comments or questions from all of you, because we are very interested in seeing how you think about how we should go about our task in implementing this section.

MR. DENNIS: Tom?

MR. KIM: Yeah.

MR. DENNIS: Leroy Dennis.

My only advice would be, any time you do rulemaking, you're trying to protect the people from the one percent or half a percent of people that try to commit fraud, and it punishes the ninety-nine and a half percent of people that are trying to do the right thing. It just seems to me that the only way you can deal with that half percent is through enforcement.

You set your rules up to give guidance to the ninety-nine and a half percent of the people who are trying to do it right, and try not to punish those people for the half percent. They're going to get it wrong regardless. I mean, if someone's going to try to intentionally do something wrong, they're going to do it wrong. And whether the rules are there or not is probably somewhat irrelevant. It's just got to be that enforcement can come in and tag those guys when they need to.

That would be my advice, as you craft those rules. Be principled and protect them.

MR. MAEDER: I would suggest that you think now before the storm starts about what's an acceptable level of fraud. I don't expect you to answer that in this forum, but if the number of Reg D filings-- first of all, can you measure the current level of fraud? If so, let's say the number of Reg D filings and the amount of capital raised doubled. How much of an increase in fraud would you find acceptable in order to pay, if you will, for that benefit? Twice the fraud? Three times the fraud?

This is an issue that the FDA is coming to grips more and more with. How many bad events are acceptable if you're doing a lot more benefit by bringing a drug to market that you wouldn't otherwise? The best time to think about that is now before the data starts coming in. Because once the data starts coming in, you tend to get fixated on the negative examples rather than on the positive benefit.

I don't think you can obviously think about those numbers in a public forum, but it's a good thing to be thinking about in the shower.

MR. NALLENGARA: Taking from that poll, what Tom had mentioned, that your recommendation pretty much lines up with Title II. The difference I think is that there was an addition of this verification standard that, to sell to an accredited investor, the issuer needs to verify that that purchaser is an accredited investor.

At the time of consideration by Congress, they looked at why they were adding that. They were adding that for the purpose-- they thought that a simple self certification wasn't enough in the context of an Internet offering.

So what we're thinking about now, what's reasonable in the area of verification. There's a range of potential purchasers here. There could be the person that Paul deals with every day or every other-- he knows very well and comfortable that they are an accredited investor. There's also the issuer that finds its purchasers on the Internet. They have no contact, no prior contact other than through the Internet.

What's the appropriate verification standard in that context? Is it enough that they say they're an accredited investor or do they have to prove it? If they prove it, how do they prove it? That's a challenge that—where/how they show evidence. We are open to ideas. We've been thinking about that a lot.

MR. DENNIS: Well, I was just going to comment, I can check a box, if I want to commit fraud as the investor and lie that I'm accredited, I can commit fraud by checking the box that says I'm accredited, or I can commit fraud by saying I've got over the requisite number of assets, because all I have to do is type that in. Absent some sort of audit, where I go back and verify bank records, which I think is probably over the top of what Congress proposed, I don't see much difference between filling out a form with numbers I put in.

If I want to commit fraud as to lying that I'm accredited or checking a box or filling out a longer form, all I have to do is fill out the form. And just like we learned that the 15 year olds are lying about their age on Facebook to get a Facebook page, it's pretty easy to do.

I don't know how you jump beyond a client or an investor representation of some sort of fact. Whether that's a whole page or whether that's one box, I'm not sure that's that relevant at the end of the day.

MR. YADLEY: I think there is a bit of a difference about an investor who's going to lie and what the issuer's got to do. The statute says that the issuer's got to do something.

In some cases, a self certification may work. That's been at least the theory today, an offering without general solicitation where the issuer knows, has pre-existing relationship with the investor. Tom, I think the one watch word is just don't be overly prescriptive in the rule writing, because it will depend on whether you know the person.

Lona, as you say, whether it's just a blind inquiry coming in over the Internet. The idea of third parties providing information is appealing to me. Some of the comment letters have suggested it could be an attorney or an accountant, someone who's got something to lose by lying. The free market system would probably readily develop services to provide privacy, protected information, would require some sort of government oversight or certification or regulation or something so that these people aren't the perpetrators of fraud.

But I think there's lots of ways you can do it, and I don't think that the Commission can ignore what the statute says, which is that you need to verify. It's got to mean something.

MR. MAEDER: I think it actually is a very meaningful change. Fraud is fraud, but there's casual fraud and there's determined fraud. There's a difference between putting a non-existent email address on a form that you get online when you're signing up for a free newsletter because you don't want people sending you junk mail, and lying on your taxes.

I think you'll never eliminate all determined fraud. The cost would be too onerous to do that, it's probably not possible. But I interpreted this change in statute to imply that you really need to limit this to people who are really bad people who are really committing determined fraud. It's really easy when you're going down the form to check the box, and yeah, you know it's a government form and you could get in trouble. But are they really going to come and prosecute you for checking a wrong box? Oh, my hand slipped, or I didn't read it carefully, as opposed to writing down your net worth and putting down, some account numbers where that net worth is. Or including a copy of your 1040 form to verify income.

You don't want to make it onerous, but I think you want to eliminate casual fraud, and I think you can do that. I think there's a range, and you should think about it in those terms.

MR. KIM: I think it's funny that we're talking here about investors defrauding the issuer. Usually it's the other way around. But, the statute says reasonable steps to verify. We are focusing on every word of that phrase, which includes the word "reasonable." Since accredited investors come in many different stripes, if you are a registered broker dealer, you are, per se, an accredited investor.

Of course, I think we've been talking about natural persons. Natural persons are either accredited because they have over $200,000 in income or they have more than $1 million net worth. The steps that you take to verify whether somebody has $200,000 in income could very well be different than the steps that you have to take to verify whether somebody has $1 million in net worth. We are mindful of the different definitions of an accredited investor within that defined term, and also depending on what test you are meeting, the steps taken by the issuer to be reasonable-- to make sure that that person is a accredited investor may very well change.

In any event, I just wanted to get that out there.

MR. MAEDER: The amount of effort you put into filling out a tax form is onerous and not reasonable. But the amount of effort you might put into filling out a financial aid or a loan form is closer to reasonable. Getting someone to email a copy of a brokerage account statement or a bank account statement where they are allowed to black out everything but the total at the bottom, I think that's perfectly reasonable. That would afford a much higher degree of verification than just a checked box.

MR. GRAHAM: A couple of things. One is again, it seems like the real focus should be on issuers that are given the opportunity to commit fraud on investors. Then the check that we have on that is, of course, trying to come up with a system where only those people that can fend for themselves are able to participate. I can understand kind of the focus on how we make sure that an issuer is forced to make appropriate verification in that context.

But the real question seems to be, how do we keep issuers from defrauding a bunch of people out there that they don't otherwise know? But it seems to me like that fix, if you will, kind of dovetails into this whole notion of having a middle market, to the extent that that's something that can evolve and become part of our system. That's again the whole notion of having a kind of a separate securities market out there where only accredited investors can participate.

If any sort of platform like that is going to work, of course, you're going to have to devise a mechanism to make sure that there is a way that people can verify that they do actually qualify to participate in such a market where you're able to have companies operate in an environment where the people who are buying and selling their shares don't need registration level protection.

One kind of minor question though for you, Tom, is have you given any thought to limiting the ways people can generally solicit by any means conceivable? I think we're all thinking about the late-night TV ads and to what extent do we want to have a securities marketplace where suddenly you're being bombarded with somebody trying to sell stock on late-night TV and that sort of thing. Which seems to me, it wouldn't do a whole lot to kind of inspire confidence in the securities markets.

MR. KIM: Well, the statute does say eliminate the ban on general solicitation, not implement modified ways of generally soliciting. So, we have thought about that. Certainly we've gotten a comment, I believe, that asks us to actually start regulating the modes of communication.

I think I'll just note as an observation that it costs money to go on TV, even late-night TV. It really doesn't cost much money to do something on the Internet. If we are contemplating the prospect of billboards and TV commercials, I don't think that is going to be how this plays out because I am anticipating that issuers are going to go to a medium in which they can reach the most people in the most cost-effective way. As we all know, nobody watches TV anymore, or not many of us do. Not as much as we used to, whereas everybody is online. I think that really will be where you find your potential investors.

MR. NALLENGARA: But Steve, you're right that regulating the forms of communication is a way to enhance investor protections with the restriction. It was discussed during the Congress's consideration of Title II. There was discussion around restricting the forms of communication.

It didn't end up in the final form of Title II. I guess our Commission will, in the end, make a determination of whether that's part of the contemplated Title II.

MR. GRAHAM: I don't want to belabor the point, but Tom, you might not watch late-night TV, and maybe I might not watch late-night TV, and I don't know who does. And maybe it's the people who do are the ones that really need the protection, I don't want to make any assumptions in that regard.

MR. BORER: A point that's off the verification of the investor status. Sort of something I hadn't thought of or contemplated when we made the recommendation to the SEC earlier this year. But I've been hearing a fair amount with respect to this, the change in the ban on non-solicitation is going to potentially substantially enhance the visibility and transparency and pricing data in the secondary market for these private securities. With respect to the quotation of 144A securities on, for example, OTC markets. I don't know if that's even permitted in what the formal change is here, but there's certainly been a lot of discussion about it.

I think if you can have the 144A pricing up on secondary markets, you can then, when they are announcing at 144A offering, announce who the dealers or initial purchasers are going to be. Then you can probably do the same thing with Reg D securities that are in secondary hands. I wouldn't mind some comment from the staff on those provisions.

MR. NALLENGARA: John, do you find in the 144A market that this change in Title II is a meaningful one? Has there been a challenge in the QIB market to find investors? I guess in my old life I maybe wrongfully assumed that everyone had a pre-existing relationship with every QIB. So this restriction may not be as big of an enhancement as the other parts of Title II.

MR. BORER: Well, I think that it's a slope. If you all of a sudden have the public able to pull up the quotation on a 144A security bid-ask, which they can't do now, and then you allow the next step, which is you can take pricing bid-ask on pre-public Facebook shares, and then all the way down to the shares of a private company that isn't a near-term prospect for IPOs, these, in my mind, price data in that kind of a market would be general solicitation. At least in the historical context of how I looked at things from my stoop.

I think it would enhance transparency in all of those markets and therefore allow more people to be comfortable with where they're holding their securities, instead of having to go to one dealer or two dealers to get price data in order to mark their portfolios and those types of things. I think it can have implications.

I had not thought this through when we made the first recommendation because I was not thinking of secondary market transparency. But I do think, just from what I'm hearing, I didn't come up with this initially, but I've had enough in-bounds from people saying, wow, this would be really good, to be able to quote the warrants we bought in that private placement on SecondMarket out loud or even OTC markets.

MR. NALLEGARA: I mean, the Title II changes are narrowly scoped to 506 offerings, which is an issuer offering. What you're talking about is secondary market transactions and the application of Title II changes to those transactions. I mean, the scope of Title II doesn't necessarily cover that. I know many people have been talking about exactly what you're talking about.

Looking at Title II, it doesn't provide for the relaxation that some have been talking about with respect to those secondary market transactions. But it is something that we are thinking about and we have heard participants talking about. I think we have said publicly that the scope of the 506 changes in Title II are to 506.

MR. MAEDER: I have one question. There are two ways to ensure investor protection. One is to create mechanisms that *de jure* protect investors which we've been talking about. The other is to set the table in such a way that investors tend to protect themselves, which gives you a lot more leverage, obviously, because you have a limited staff.

Does the Act allow you or accommodate doing some of that, for an example, some kind of a waiting period, a lemon law? If I decide I want to make an investment, I fill out a form. I have seven days or five business days to rescind when I come to my senses and realize that I acted impetuously? Is there any opportunity for those sorts of things that allow people to effectively protect themselves? Because that's the spirit of the sophisticated investor rule.

MR. KIM: Today, Rule 506 does not have those conditions. That doesn't say that we don't have the power to implement those conditions if necessary. But today it doesn't, and it will be interesting to see what people think about those types of ideas. It may or may not be necessary.

But certainly today, as you know, it does not have those conditions. We'll see if you want to provide us with some further ideas about that, you should absolutely submit a comment letter to that effect, because those are interesting ideas.

MR. YADLEY: As you may know, some states including Florida have such a provision. If you sell securities to more than five people then there's a right of rescission that begins when you tell the investor about that. I've never had it come into play, but that's probably because we've had more sophisticated investors, so it's not to say that it's not a good idea for this retail Internet world.

MR. NALLENGARA: Let's move on to Title III. Interestingly the discussion that was talking about rescissions and lemon laws, and we're moving on to Title III which is crowdfunding. I think if you all remember, the Committee didn't provide a recommendation on crowdfunding. Crowdfunding has elements that relate to the Division of Corporation Finance which Jennifer, Gerry and I work in. As well as there is a broker-dealer intermediary aspect which our colleagues in the Trading and Markets Division have responsibility for.

We have members of our staff who are working on the crowdfunding rulemaking for both divisions. I'll introduce all of them and then they will divide up and talk to you. Lily Brown is a Senior Special Counsel to Meredith, our Director. And then at the end, I think you met David, David's a Chief Counsel in the Division of Trading and Markets. With him is Ignacio Sandoval who is a Special Counsel in the Office of the Chief Counsel. I think we're starting with Lily and then we'll move on to David and to Ignacio.

MS. BROWN: Hi. As Lona mentioned, I'm going to be talking about Title III of the JOBS Act which creates a new exemption from registration under the Securities Act for crowdfunding transactions that meet certain conditions, including with regard to the maximum amount that may be raised in a 12-month period and also the maximum amount that may be sold to any individual investor, again in a 12-month period.

I understand that the Committee had extensive discussions about crowdfunding and whether to make recommendations for rulemaking to the Commission at your last meeting, and ultimately decided not to provide recommendations in this regard based on some concerns raised by many members of the Committee.

Just as background and a refresher from the last meeting, crowdfunding is a new and evolving way of fundraising over the Internet. Typically by small ventures, either to buy something new for their business, or you might have someone who's undertaking it for research or for artistic endeavors, recording a song or making a film. The idea is that you go out to the Internet and find many individuals willing to contribute small amounts for whatever the endeavor is.

There are various models for crowdfunding, many of which do not implicate the federal securities laws. For example, a donation model where an individual contributes funds without the expectation of anything in return. Also, a reward model where you have someone contributing funds and they might get some token item in return like a t-shirt or a hat.

There is also, though, and more relevant for us here, an equity model where there is an expectation that the person contributing the funds will get an interest in the company in return. There we have the federal securities laws implicated and you either are going to need to register that offer or find an exemption. Traditionally registration has not been a viable alternative for these small ventures.

Similarly, the exemptions that have been available may not have been a perfect fit. For example, with 506, prior to JOBS Act there was no general solicitation allowed, which obviously is very fundamental to this form of capital raising. Even with the JOBS Act changes, which would allow the general solicitation, it still may not be a perfect fit because you likely are not going to get all accredited investors in one of these transactions.

Title III provides kind of an exemption that is tailored to this specific form of capital formation. As I mentioned, it has several conditions, investor protections that were built in directly in the statute. It does require Commission rulemaking before the exemption will be available for use, and that rulemaking is required within 270 days of enactment.

This will be challenging. This will be a challenging deadline to meet, but we are at work on it. We have, as Lona mentioned, teams in both Corp Fin and Trading and Markets working on it and we've gotten some good inputs through our preliminary comment mailbox on the web site. We've met with many interested groups, this is an area where people are very interested and eager to start using the exemption. We're taking all of this into account as we kind of put together these recommendations for the Commission.

There are several conditions, and in the interest of time I'm just going to hit on them very briefly. As I mentioned, there is a limit on what can be raised in a year, up to one million in securities. Also a limit on what an individual investor can purchase, $2,000 or five percent if they have an income or net worth up to $100,000. Ten percent of their net worth or income if they are above that $100,000 mark, with a cap at $100,000.

One of the key kind of investor protection pieces of the statute is that these transactions must happen through an intermediary. That's the middleman between the issuer and the purchasers. Ignacio and David will be talking about that a little bit more. There are also several requirements for issuers who would like to rely on this exemption, and a lot of those center around, as you can imagine, disclosure.

The statute sets out pretty specifically some of the disclosures that will be required, and many of them would be familiar to all of us. Description of your business and financial condition. Description of the securities being offered, the price and how that was determined. In this context also the target amount that they're seeking to raise and when that target needs to be met. There would be updating there.

Another significant area would be with regard to financial statements and there are tiers for what would be required with regard to those statements, depending on how much you're seeking to raise. They may need to be reviewed, they may need to be audited, just depending upon what you're seeking to raise there. There would also be kind of ongoing reporting obligations with regard to the financial statements.

What else can I hit on quickly? The Commission is also required to develop disqualification provisions for bad actors, those who have committed securities law and related violations. There are also some pieces that relate to the securities themselves. They would not be able to be transferred for a year after the sale, except in specific circumstances -- a registered offering, a transfer back to the issuer, transfer to a family member, transfers in relation to life events like death or divorce, to accredited investors as well.

The other, kind of the last piece, I guess I'll hit on is with regard to section 12(g) reporting. The Commission's also tasked with amending our rules under section 12(g) to exempt crowdfunded securities from that section.

There are a lot of interesting issues here in terms of implementing the statute. What we're talking about with regard to financial statements-- those kind of implementation issues. There are also kind of bigger picture issues that we're asking ourselves and others and that we've heard about in terms of, for example, what types of securities would be offered. Would it be the same class that the founders and principal shareholders have or would it be some different class where shareholders might have lesser rights? How to deal with liquidity issues for shareholders and whether there will end up being an active trading market for these securities and that type of thing.

But I'm going to go ahead and turn it over to Ignacio so he can talk a little bit about the intermediary stuff. I hope I left you enough time.

MR. SANDOVAL: It's perfect. Thank you, Lily. As Lily mentioned a little earlier, in Title III one of the conditions for these offerings is that the offering occur through an intermediary that's either a registered broker or registered funding portal.

In addition, an intermediary has other obligations it needs to satisfy. So before I discuss what the intermediary requirements are, I think I want to touch briefly on what a funding portal is and how it fits within the existing framework of the federal securities laws.

"Funding portal" is a newly defined entity that limits its brokerage activities to crowdfunded securities transactions. So by definition, a funding portal can't offer investment advice or make recommendations, so the purchases or sales for the crowdfunded offerings compensate anyone for soliciting or based on the sale of crowdfunded securities offerings or hold, possess or otherwise handle funds and securities. It's a very limited set of activities that can be engaged in.

Consistent with these limitations, the JOBS Act directs the Commission to exempt funding portals from having to register as brokers under Section 15(a). Though there are a number of provisions, crowdfunding provisions that are floating around, some would have excluded funding portals, or their equivalent, from the definition of a broker. What Congress eventually did was direct us to exempt them from having to register. That's where they eventually came out.

One of the conditions that the exemption has to be based on-- or there are a number of conditions under which we have to exempt funding portals from broker-dealer registration. One, they have to be registered with us as funding portals. Two, they have to remain subject to the Commission's examination, enforcement and rulemaking authority. Third, they have to become members of a national securities association that's registered under Section 15A of the Exchange Act.

Today, the only association meeting that bill is FINRA. As a practical matter, they'll have to be members of FINRA once the rules become effective.

Now over to the intermediary provisions. A crowdfunding intermediary is either a broker or a funding portal. Both will have to be registered with us. By operation of law, the broker will also have to be a member of FINRA. FINRA will generally have oversight over both of them.

There's a number of requirements that the intermediaries have to satisfy when effecting crowdfunding securities transactions. One is they have to provide investors with educational material that informs investors about the risks associated with crowdfunded securities. I mean, currently, an analogy is in the penny stock realm. When a broker makes a recommendation in a penny stock security, they also have to provide certain educational material.

There is something in existence already there. But the second part to this is that, in addition to the educational material, intermediaries must ensure that each investor reviews the educational material, positively affirms that the investor understands the risks of the investment, in particular how they can lose all their money. Third, answer questions demonstrating that they understand that there might not be like a secondary market for these once they enter into the investment.

Intermediaries also have to take measures to reduce the risk of fraud with respect to the issuers using the platform. With respect to the issuers and the people associated with the issuer. They have to make the offering available for 21 days before they can effect a transaction and make all the disclosures that an issuer makes available under its requirements.

They also have to protect investor privacy information. So a lot of that sounds familiar to existing Reg S-P under our rules, so we'll have to reconcile those provisions. Another point is that the intermediaries have to take steps to ensure that the offering proceeds aren't made available to an issuer until a target offering amount is met or exceeded. But they also have to give investors the opportunity to cancel the investment. We have to reconcile those provisions as well.

I think there's an existing framework under the federal securities law for this. I think they're Rules 10b-9 and 15c2-4, so we have to see how those fit in with how these offerings would work.

Finally, the intermediary is prohibited from having an interest in the issuer using its services. Principal transactions, I think, are just not going to be available or intermediaries wouldn't be able to engage in principal transactions.

As was mentioned earlier on the web site, we're already soliciting public comment on all of these. The crowdfunding provisions have-- we've received a lot of comments in that area. We're keeping them in mind as we adopt. But, we have to work in parallel tracks, so we have to propose and adopt our rules. In addition, FINRA would also have to adopt rules governing membership and conduct with respect to funding portals. Because the way the Title III works is that FINRA can only examine and enforce rules really specifically for funding portals, if they choose to register that way. I think that's probably going to engender a new rule series governing funding portals.

But I mean, that being said, I know there wasn't a recommendation the last time the Committee met, but I'm wondering if there's any insights or comments or views that you'd appreciate sharing.

MS. MOTT: I have concerns. The angel investor community right now-- let's put it this way, if you look at the conveyor belt theory for an emerging growth company, particularly for companies that are going to be the Microsofts, the big ones, the Facebooks, the capital intensive companies like clean technology companies, medical device companies, essentially when they're financed, they start out with friends and family currently, and incubator money and maybe some NIH money, angel investors and VCs.

How I see this crowdfunding becoming maybe part of the friends and family round, what I'm concerned about is how it's structured and whether or not sophisticated investors would be interested in following on. They may be concerned about lawsuits based on a whole group of very unsophisticated investors. Is the security structured so it can provide some liquidity? All of those questions are coming up. We're concerned about whether or not we are going to have a disruption in the market, particularly for capital intensive kinds of emerging growth companies.

Would a medical device company that needs $30 million for all its clinical trials get the $30 million they need because they went out to crowdfunding and got the initial funding? It's a great concern for sophisticated investors to follow on. So how it's structured, what kind of risk and cost are associated with bankrolling suits, lawsuits with crowdfunding companies with sophisticated investors are a great concern.

MR. NALLENGARA: I was just saying that in the short time and even before JOBS, that we've met with a number of different organizations and there's incredible excitement around crowdfunding. We're working very hard to put the rules in place. We're taking the same approach we are with other parts to try a practical application of what Congress has mandated, keeping in mind the need for the appropriate investor protections.

One of the questions that forms part of the discussion is, I think, Catherine, part of your question is where this fits in the life cycle of a company? That's a question that we've discussed with a number of groups that have come in. Some have indicated that it could be a number of different places. Some have said it's after someone's tapped their friends and family and they still need more, and there isn't an angel group like yours or there isn't a bigger investment group like Paul's to come in. They may be geographically located somewhere where there isn't as robust a network.

Some have said that they view that capital as one that comes in at that point, but also comes out at the time a bigger investment comes in, a larger stakeholder comes in. I don't know if some of the investors on the Committee have thought about investing. I know we talked about it a little bit at the last meeting, when you were considering crowdfunding, but coming into an investment, as Catherine mentioned, where there has been a crowdfunding round. Is that something you would focus on? How much would that play into your consideration of the investment?

MR. MAEDER: It would for the reasons Catherine mentioned. We've finally gotten to the point where we've done a reasonable job of educating angels how not to mess up a capital structure so we can follow on invest. I think the angel community now is pretty savvy about this and now there's going to be a whole new group that comes along.

But I think the funding portals will help facilitate that, and that will be part of their job, not regulatory job, but market job. Some will do a better job of it and some will leave companies stranded. So people will learn, you use some, you don't use others.

MR. GRAHAM: I think. Excuse me, Paul--

MR. MAEDER: No, go ahead. I've got a separate comment.

MR. GRAHAM: Okay. I think Catherine clearly makes a very good point. I think that's a concern that we as a Committee had. I don't know to what extent that can be addressed, but certainly to the extent that it can be addressed, I'll leave it up to you in your wisdom.

But Lona, you mentioned that you've seen a lot of excitement behind crowdfunding. I'm just wondering if you can tell whether that's excitement on the part of potential issuers that might not otherwise be traditional candidates for VC funding? Or are these more the kinds of companies that I think we're all kind of concerned about, that just otherwise are just not going to attract capital from any source?

MR. NALLENGARA: Lily, correct me if I'm wrong. I think what we've been meeting with are the portals or the groups that are organizing around crowdfunding. We haven't -- I don't think we've really met with issuers, we've met with entities that will serve as, or will want to serve as--

MR. GRAHAM: So the excitement is around those that want to be the intermediaries as opposed to--

MR. NALLENGARA: Those that want to be the intermediaries, right.

MR. GRAHAM: More like kind of understanding who might want to actually participate as an issuer?

MR. NALLENGARA: Right. We've met with members of groups that will serve as associations for crowdfunding participants, both issuers and intermediaries. We've met with ancillary service providers. There are groups that are developing to serve as a diligence mechanism as part of the crowdfunding opportunity. The intermediary won't be able to serve the diligence function, but you could have a third party give the stamp of approval that we've looked at, and I'm not sure what they would look at. But that's the idea behind it.

There clearly are jobs being created around crowdfunding. We'll wait to see whether the offerings will come and also produce jobs.

MR. MAEDER: With respect to that, I think the class of companies that should raise venture capital is a relatively narrow part of the whole pie. I don't think you should raise venture capital unless you need to raise venture capital, and the only reason you need to raise venture capital is because your competitors are raising venture capital and it's a fast moving marketplace.

Venture capital tends to be limited to high growth technology intensive business where there's a lot of change, not to hairdressers. I think of crowdfunding as being more appropriate to relatively slow growth, not technology intensive businesses. That's a whole class that we don't even look at. I hope the crowdfunding mechanism goes to those rather than going to just the adverse selection of second-rate technology companies.

I have one question --

MR. GRAHAM: Before you leave that, Paul --

MR. MAEDER: Yeah, go.

MR. GRAHAM: -- and that would leave, I think that you're exactly on with respect to that point. The part that seems kind of inconsistent because if that's the group that you're focusing on, in some of these systems and processes we're thinking about setting up in order to provide for investor protection are going to kind of knock those businesses out of the box it seems. Because there's going to be some real expense associated with compliance.

MR. MAEDER: Yeah. That's the balance that has to be struck. You're absolutely right.

MR. LEZA: Let me make a comment. I really don't see a problem with this because most of the people that are going to go into crowdfunding are not the people that are going to be able to get venture capitalist money. Because like Paul was saying, the high growth, sophisticated people.

The other thing is, if you look at it way back 20, 25 years ago, when the venture capitalists were basically a lot of Menlo Park and Palo Alto. Then the angels started playing the game, oh, they were real worried that they were going to take all this business and stuff like this.

What it finally turned out was that the angel people were investing in companies and things that the venture capitalists weren't doing. Not until years later did they become more sophisticated that they actually get into the funnel that they were stepping into the venture capitalist business. But I think crowdfunding, I don't see it like that, and I don't see that it ever is going to get to the venture capitalist area.

MR. MAEDER: There are two obvious reasons why that I hope, and I think you have it for the same reasons, Steve, that it goes to the non-venture qualified companies. But the biggest reason is that I think the failure rate will be a lot lower if it goes to non-qualified, if it goes to hardware stores or low-growth businesses. There is going to be much lower venture failure rate than if it goes to companies that just aren't good enough to qualify for venture capital but still want to play in that very, very competitive pond.

I've got a question about, you made a comment about bad actors, and I've got a question about rating. There's an obvious opportunity that's going to arise from all of this, for a rating site, web site. Not an agency, but a rating web site to rate the performance of both investors and issuers along the lines of the star system that you see at eBay. I think there's an opportunity-- and you used the term bad actors, I think there's actually a whole gradation. There's bad actors who sign up and don't send in the check, and then there's people who send in the check late, and then there's people who are very reliable, and the same holds true for issuers.

The question I have is, do you intend to make it a requirement that the funding portals provide a rating mechanism? Or are you going to create a rating mechanism? Or are you going to let the market go out and start a bunch of rating mechanisms and have the most popular emerge as the winner in that?

MR. BLASS: I'll enter on behalf of the funding portal. The statute prohibits a funding portal from providing any investment advice or recommendation so it makes it very difficult for us to actually require a funding portal to do a rating system given that the statute prohibits them from doing that. Certainly the market could develop a rating system like that, from our perspective there's nothing to prevent that from happening. Whoever would want to offer that service needs to think through whether they're an investment advisor or not, but it certainly can be done.

I would say Ignacio hit the point right on the head, that the funding portal is not the only mechanism for crowdfunding issuers. You can also go through a registered broker-dealer. And the ban on making recommendations and providing investment advice does not apply to registered broker-dealers. Of course, they have a fairly robust set of regulatory requirements that they have to comply with, so you have all the suitability, fair and balanced disclosure requirements that

FINRA and we impose. But there is that mechanism for crowdfunding issuers that would accommodate a rating system possibly, and more information about the issuer.

MR. MAEDER: That will be interesting to see. It will probably be a matter for the courts to decide whether having a web site where people can write in Ignacio's reliable and he sent his check on time, whether that constitutes investment advice or not.

MR. BLASS: To be very honest, that's an issue that we're working hard through. Because what we've heard from some of the funding portals is they'd like to have some degree of discretion on who lists on their portal. You can understand why they'd want that.

We have the Investment Advisors Act of 1940, so 70 years of having regulated investment advice, so some history to draw from on what is investment advice. We're trying to reconcile what we think of as investment advice, what funding portals would like to do.

This is a difficult area for us, so we're working through it. We hope to give some guidance to the funding portal community on how we think of investment advice in that context. It may be different than the Investment Advisors Act context. That's something we hope to flesh out a little bit in our proposing release.

MR. GREENE: Let me make a comment on the conversation that we had and then just talk about a question.

We have seen tremendous excitement, not only from the potential intermediaries, yes, they're very excited. But also from the broader entrepreneurial community. I would differentiate, as Paul said, that there's a difference between the Main Street, the hair dresser, et cetera, and a company with high growth potential.

Although, if you look at the data, it really is a tiny subset of even high-growth firms who actually get venture funding. So Kaufman studies have looked at the Inc. 500 over a ten-year period and shown that only 16 percent of those firms actually got venture funding because there are certain industries that are venture appropriate and there are others that aren't. Again, we're seeing a high level of excitement from the entrepreneurial community about this and wanting to see how it plays out.

Which segues into my question which really is more process. First is the 270 days for proposed or final rule? We get asked all the time by different players how can they provide input into this. These aren't people who are used to submitting comments to the SEC or anybody else. They don't hang out at federalregister.gov, so any guidance that you can give about appropriate ways for people to give input.

Then the final question around that is, maybe you've already done this, but as with an advanced notice of proposed rulemaking, are you going to issue a targeted set of questions that in particular you would like specific feedback on a range of issues?

MS. BROWN: Okay. So the 270 days is for the Commission to complete the rulemaking. That would encompass a proposing release that the public would then have the ability to comment on. Those traditionally include a broad range of questions, very targeted, so they'll have the opportunity to comment there. Then that would be taken into consideration in final rules.

But there's also the opportunity right now for the public to comment on the preliminary comment web page that the Commission set up for the JOBS Act, similar to what was done for Dodd-Frank. So we have received a number of comments already and those have been very helpful. We also have folks who want to come in and meet with us, and that's helpful to talk through the issues, although it's always most helpful in actually developing the rules to have something in writing that we can point to.

MR. NALLENGARA: If folks want to come and meet with us, we're happy to do that, contacting Lily or Ignacio is the right way to do that. If you're talking to people about providing us with pre-proposing release comments, we have the statute and the statute says certain things. It says the maximum amount that can be raised. A comment that says it should be five times that isn't entirely helpful for us.

If people can keep the comments within the statutory framework and help us where there is discretion, where there is in any other thing the SEC decides to do, it would be helpful to know what people think those any other things would be.

MR. CHANG: Seems to me the biggest problem with crowdfunding is the likelihood of liquidity. We must find some ways to address that.

MR. BORER: I've got a comment that goes back to the sort of unforeseen consequences that the IPO market is not easy and open. And we have a number of clients in the life sciences industry, going back to the beginning of '11, there have been 12 life sciences IPOs completed and 14 withdrawn. So the odds are not in favor.

But a lot of these companies have been around for ten years, they've been through A through F rounds of private funding, they're in phase two or three, they've got a lot of comps in the public markets that are valued high, but it's still very tough to do the IPOs.

One of the things we've been talking with certain clients about is using this crowdfunding mechanism as a means of acquiring-- and especially because of the seasoning requirements now around reverse mergers on the exchanges, as a mechanism to get the requisite round-lot holders to, upon completion of the offering, filing a Form 10 or S-1 and 8-A, and then a 211. Once that's effected, to actually get on to the NASDAQ in a very short order.

Just any comments around that, where there's any flaws in that from a technical perspective around the bill? Because obviously crowdfunding is not intended for a company that's had 150 million of funding already and is well along in its life.

MR. NALLENGARA: I'm not sure, John, I follow entirely the question. But could I--

MR. BORER: Let me restate. In the past, companies would come to us that have had 100 million of funding. They're through phase two going on to phase three. Their venture capital and private equity investors are tired, they're on three funds later and they'd like to have level securities in their portfolio, which means public company, freely tradable and with a market so they can pass them out to their limiteds or otherwise.

We've done those things in the past through reverse mergers which allowed the companies to become public, fully reporting. In the past, before the seasoning requirements that were put in place this last year around reverse mergers, if they met all the other qualifications-- go apply to NASDAQ and be listed on an exchange, not be a penny stock, and be a good security.

Well, you can't do that anymore, you have to wait for one year, make all the filings, et cetera, and you still need to have the requisite number of holders, round-lot holders in order to qualify for that listing. This might be a vehicle for a company like that to be able to do that. So do your crowdfunding round. You've already had 100 million invested in you. Now you'll get another 400 holders. You'll file your Form 10 or a Form S-1 and an 8-A, let it be cleared, have the 211 filed and then wait and then go apply to NASDAQ immediately instead of having to wait.

MR. NALLENGARA: I don't think we've thought about that. I also didn't think that that company that you described would be the company that would seek their-- I guess you're suggesting that they would do crowdfunding simply to increase their number of holders to--

MR. BLASS: Are you saying it increases your holders of record?

MR. BORER: Yes.

MR. BLASS: The crowdfunding holders don't count.

MR. BORER: In that case, the exchange would not count them of record?

MR. BLASS: I don't know if they would. I don't know the answer to this, so I don't want to get a resolution--

MR. BORER: Preliminarily what we've heard is for exchange rules, not with respect to what you have to do to file to be a public company.

MR. BLASS: Got you.

MR. BORER: But the exchange rules, they would view them as round-lot holders, as long as they hold 100 shares of stock.

MR. NALLENGARA: I hadn't heard of crowdfunding being used to increase the number. But thank you for telling us about that.

MR. BLASS: Yeah, I mean, I think what you're saying is that the crowdfunding mechanism, someone might try to use that to meet minimum listing standards at the exchange, and like Lona said, I don't think we've heard that that was in the business plan of some crowdfunding issuers. I think we need to think it through. I don't think we have a technical answer for you today.

MR. BORER: Well, it's-- that type of a cure, because we came up with these reverse mergers for these life sciences companies and there have been some very successful ones in the past that have gone into Form 10 shells, so not legacy shells. But even the Form 10 shells are still subject to the seasoning requirements of the exchanges, which is problematic.

MR. YADLEY: Another point that follows up on a couple of thoughts, the idea of a private placement broker or an intermediary that can help smaller companies raise money has been a topic of great interest to me personally. It was also a recommendation of the last Small Business Advisory Committee and the last five or six small business forums.

I think the points about who should be a crowdfunding company and who shouldn't are right on. But we know that. The problem is these little companies don't know that. This is a way to get a million dollars, and the limitations that the legislation places on the funding portals is a real limitation if they can't guide them.

So a broker-dealer would be terrific because a broker-dealer, subject to regulation, would know to advise the company that crowdfunding maybe isn't the way to go. Or when they come in and say we want to do this, and then we want to do venture capital, they can advise them that they're a long way from venture capital. They can talk about Reg A or new 506 or whatever.

I would encourage the staff to continue to talk with members of the public and the Bar and other groups that are interested in having a broker-dealer with limited responsibilities and limited regulation, because this may be a real benefit to these companies who are unsophisticated and they won't really know what kind of advice that they need in order to seek the financing that makes sense for them.

MS. MOTT: That's what I was going to say. Entrepreneurs go where the money is. I have even seen entrepreneurs say, hey could I borrow your legal docs to create this convertible note instrument or so I can go out and collect money. They go where the money is. I think having some guidance by the brokers, I think would make sense.

We are not against the hair dressers, the dry cleaners-- whatever that need to get. What we're worried about is companies that need money, the venture system which we're going to talk about soon, about the lack of venture capital in the marketplace. Angels are taking that place and we're still not being-- we funded a life science company $28 million, it's getting its CE mark and now it's going to be on the marketplace without VC money. But I would much rather work with VCs on that and get it to marketplace sooner, more efficiently.

I guess what I'm saying is, somehow I'm hoping that something can come out of this that can direct people to the right models in the right securities so that it can efficiently and effectively grow the company, get the kind of funding it needs and move on.

MR. LEZA: John, can I just make a comment? John, I'd like to thank you for your comments, because it really opens a kind of a creative idea on the loophole of crowdfunding for these companies.

MR. BORER: It's not a loophole. I didn't say that.

[Laughter.]

MR. LEZA: It sounds like one.

MR. NALLENGARA: We are well into our break. We do have two more, if Chris and Steve--

MR. GRAHAM: We started late, so let's just plow through for another ten minutes maybe.

MR. NALLENGARA: That would be great. Title IV, it's the modification to Regulation A, which we've affectionately been calling Regulation A+ on the staff. I'll turn it to Gerry to give us a short summary on.

MR. LAPORTE: Sure. Thanks, Lona. As Lona mentioned, Title IV requires the SEC to create a new exemption from registration under the Securities Act similar to the current Regulation A but with an increased maximum offering amount of $50 million annually. As you know, from the Committee's consideration of this issue at the February 1st meeting, the current limit on Regulation A offerings is $5 million annually.

In addition, the JOBS Act requires that companies relying on this new exemption file audited financial statements with the SEC annually. The SEC can create this new exemption either within or outside current Regulation A.

In your packets, you got copies of the Regulation A recommendation that the Committee made to the Commission last February. You'll see that what Congress adopted is very similar to what the Committee recommended.

Under the new exemption which we, as Lona mentioned, we've been internally referring to as Regulation A+, the issuer can make a public offering to whomever it wants, retail investors included, and may engage in what's been called test the waters activities before filing of any full offering document with the SEC under rules that the SEC may adopt. The securities sold under this new exemption will not be restricted securities so they can be resold freely in ordinary market transactions.

One of the things that the JOBS Act specified-- or clarified was that the anti-fraud civil liability provisions in Section 12(a)(2) the Securities Act will apply to offering documents used under the new Regulation A+, but there's no Section 11 strict liability like you'll find in a registered offering.

The JOBS Act gives the SEC new authority to require issuers that use Regulation A+ to make available to investors and to file with the Commission periodic disclosure documents on their business operations and financial position, so these disclosures, if required by the Commission, would provide ongoing information to any secondary market that develops.

The JOBS Act envisions that the SEC may want to require that Regulation A+ offering documents be filed electronically with the SEC and that the SEC may want to adopt bad actor provisions that apply to these new offerings. Regulation A currently has bad actor disqualification provisions, although Reg A filings are not made electronically. This Committee's recommendation back last February, you recommended both of these provisions.

Under the JOBS Act, offerings under the new exemption would not be exempt under state blue sky regulation unless the securities are traded on the national securities exchange or the SEC exercises its authority under current law to define the term qualified purchaser under the Securities Act to include categories of investors that purchase in Regulation A offerings.

The SEC's Regulation A rulemaking team is working diligently on a proposal to recommend to the Commission and we welcome any input that the Committee may want to provide. In that regard, you may want to look at your previous recommendation and see whether you reaffirm what you said before, or now that Congress has put more meat on the bones, whether you've changed your mind or have additional recommendations to make. We'd also be pleased to respond to any questions or informal comments that you may have, may want to give us. Thanks.

MR. NALLENGARA: If there's no questions on Regulation A+, we'll move to the last section. I'm sorry to give Steve Hearne, who's a Senior Special Counsel in our Office of Rulemaking a limited time because Steve is probably our most knowledgeable person on thresholds for public reporting and 12(g). I feel like Steve's been working on this for the better part of his career here at the SEC. With that, I'll turn it over to Steve to talk about the changes with the JOBS Act.

MR. HEARNE: I'm in the enviable position of standing between you and a break, so I know I need to be brief. I had this long treatise spelled out, I was going to tell you all about the beginning and end of 12(g), but I'll just stick to the JOBS Act.

As you guys are aware, Titles V and VI adjusted the thresholds to the JOBS Act. Title V focuses on non-banks and bank holding companies and Title VI on the banks and bank holding companies.

For non-banks and bank holding companies, they raised the threshold statutorily for the dollar threshold to $10 million, which we had done by rule previously, but now it's in the statute. They also raised the threshold to 2,000 persons or 500 persons who are not accredited investors. That creates some issues that we'll talk about a little bit later.

But I just wanted to highlight your recommendations had been to just go to a 1,000 person number. Congress decided to do something a little different with the 2,000 persons and 500 non-accredited investors. They didn't go with the recommendation of the Committee to raise the exit threshold generally to 600 and just left that. Title V really focused on requiring companies to come into the system and not on the exit side.

Title VI which focused on banks and bank holding companies raised the threshold to 2,000, a flat 2,000 without the non-accredited piece, which gives a little more flexibility to the banks and bank holding companies. They also raised the exit threshold for banks and bank holding companies to 1,200 persons.

In addition, the JOBS Act went ahead to exclude securities held by persons who received the securities pursuant to an employee compensation plan in transactions exempted from the registration requirements of Section of 5 the Securities Act for purposes of determining whether an issuer is required to register with the Commission, again on the coming-in side. That was slightly different than the recommendation of the Committee which had been a slightly more broad recommendation that you exclude employees who are appropriately restricted from trading the securities.

There again, the Congress went in a slightly different direction. The same idea to get these employees out because they probably didn't need the same protections that non-employees did. But thinking of it differently as opposed to trading, which was the focus of the Committee. Their's was I think more centered on the thinking of the options thinking that we'd had in our rulemaking previously.

There's also the crowdfunding provision which gives us the authority to create exemptions for crowdfunded securities, because again with crowdfunding and as we talked about, that has the potential to add a whole new wave of investors. If they were to require reporting at that point, I don't think it would address the kinds of companies that they were looking to get funding to.

Then finally, we were asked to provide a study within 90 days of whether we need new enforcement tools to enforce the anti-evasion provisions of Rule 12g5-1(b)(3), which is the rule that says you can't go around and create record holders to avoid the 500 shareholder threshold.

All of these changes have led us to a few interesting questions and some uninteresting ones. But for the most part, we would love to get comments. We've got the page up currently requesting pre-proposal comments. There will be proposals related to a lot of these issues for 12(g) because we need to clean up the rules. Then we also have some open issues about how to interpret the statute as it was changed. Specific data and studies on those issues are particularly useful to the staff and estimates of any costs and benefits would help to inform the staff and the Commission when we make decisions related to these things.

Some of the issues that we think people really need to think about is on the accredited investor side. Now that issuers need to determine whether they have accredited or unaccredited investors, in order to, for a non-bank or bank holding company to rely on this new higher 2,000 person threshold, they need to now differentiate between their accredited investors and their non-accredited investor record holders.

That means that investors, particularly those that are in secondary market transactions who don't have a current or ongoing obligation to provide the information on their accredited investor status to the issuer, it creates an issue for how that issuer is going to be able to rely on the new 2,000 number, which it seems that Congress wanted them to be able to do. We need to figure out how to make that workable in the statute and in our rules.

There is also the change to exclude securities held by persons who received their securities pursuant to an employee compensation plan. We need to figure out what it means to be an employee, what it means to be an employee compensation plan how we should relate that back to prior exemptions. What that does to some of the current exemptions for stock options that are currently on the books, and so all of those things we're thinking about and trying to formulate recommendations.

On the bank and bank holding companies side, we received a letter from the Independent Community Bankers of America noting an issue in the statutory language that was provided. In the statute they referred to bank holding companies as defined in the Bank Holding Company Act of 1956, which doesn't include savings and loans and other thrifts. They sent in a letter requesting that the Commission provide guidance indicating that thrifts and thrift holding companies should be considered as banks and bank holding companies for purposes of the JOBS Act. That's something we're looking into as well.

That's my speed performance. I hope I didn't keep you here too long.

MR. GRAHAM: No, you did not, and thank you, Steven. Shall we take a break now and reconvene-- okay, so what, 11:05? Okay.

Morning Session Continued after Ten Minute Break

MR. GRAHAM: Let's try to reconvene. Our next subject is going to deal with structure issues in the marketplace. I'm just going to flip it back to you, Lona, so you can kind of introduce the topic and our panelists.

MR. NALLENGARA: Thanks, Steve. We're looking at market structure issues in our second panel, and with specifically a focus on the impact of decimalization on the number of initial public offerings, particularly with respect to smaller companies and the impact of decimalization on liquidity for securities of small and mid-cap companies. The impact of decimalization has been long written about as part of market structure conversations.

It's been debated by market participants and by academics. We're lucky enough to have two of the most prominent ones here that are going to provide you their views on the impact of decimalization.

There are more extensive biographies of our two speakers in the materials, but I'll briefly introduce both. David Weild, I think many of you know, is the chairman and CEO of Capital Markets Advisory Partners. It's the firm that specializes in innovating capital equity market solutions for issuers and is known for its understanding of how market structure impacts capital formation and job creation.

David oversees the capital markets and institutional acceptance at Grant Thornton. He is the former vice chair and executive Committee member of NASDAQ. Prior to joining NASDAQ, David spent 14 years at Prudential Securities. He's authored a number of papers on market structure issues and the change in the IPO market, which I think have been in materials for prior meetings.

After David, we'll hear from Dr. Jeffrey Harris. He's the Dean's Chair in Finance at the Whitten

School of Management at Syracuse University where he teaches investments and derivatives courses. Dr. Harris has an extensive background in and his research focuses on microstructure of stock and derivatives markets with applications to capital formation and trading behavior and regulatory issues. He has recently served as chief economist at CFTC and prior to that he was a visiting academic at NASDAQ, and even before that, we were lucky enough to have him work here with us. Dr. Harris's research has appeared in a number of prominent journals.

We're also lucky to have some of our staff members who are our experts in the market structures we're going to talk about today. At the end beside Gerry is Gregg Berman. Gregg is a Special Advisor to the Director of our Division of Trading and Markets. Kathleen Hanley, who I think many of you have met at prior meetings, is the Deputy Director of the Division of Risk, Strategy and Financial Innovation. That's a great name for our economists. Kathleen is our Deputy Director in charge of all of our smart people here at the SEC.

With that, I will turn it over to David, if the technology will cooperate.

MR. WEILD: Thank you, Lona. I appreciate it. We're all good to go. I have three affiliations. I wanted to first of all, I was listening to the discussion before, and I have to tell you, I am so encouraged that this is the sound of jobs being created around this table, and I want to thank everybody and the Commission for the hard work that they're putting forward on this to kind of smooth out the rough edges of the JOBS Act and figure out where we go from here. But for the first time in a long while, increasingly optimistic. That said, I think that there are some big things that are missing from the JOBS Act which I'm going to talk about.

But before I do that, just so everybody knows my affiliations, I want to mention Grant Thornton and Capital Markets Advisory Partners. I also chair the Small Business Crisis Task Force for the International Stock Exchange Executives Emeriti, which is a global group of mostly CEO-types from the exchanges. We actually have one, a former chairman of the SEC that participates with us. These are folks that are really interested in market structure as it's changed.

I will just pass along that people are concerned about the direction that decimalization and tick sizes have created, how it's beginning to undermine potentially-- the view is, at least in this august group, capital formation globally. We're going to talk about that.

I'm a practitioner with an analytical bent, and so for me it was a little laborious. I went through in preparation for this meeting, I read through about 40 academic articles, mostly by micro-market specialists. My takeaway from that was that everything that I have seen measures relatively short-term changes in market structure. There's an event, for instance decimalization, and we look at the period of time three months before decimalization, three months after and we say, what's happened to liquidity? It doesn't take into account that some of these market structure changes have very long-term and deleterious consequences to the broader echo system.

We're going to discuss that today. But suffice it to say, I think that these penny ticks are sort of akin to telling people that smoking is glamorous and it helps you focus, because it gives you a shot of nicotine. There's nothing wrong with it. Then 10, 15, 20, 30 years down the road to you start to wake up to the fact that it causes emphysema and people die of cancer.

I think that that's what going on in the micro markets of the United States, the smaller cap markets, that we've unleashed the equivalent of a flesh-eating bacteria that's gobbling up the support mechanism that creates visibility for companies. I want to ask you to just use your good common sense to say, if you are a little biotech company here, who keeps you visible at a penny spread a share? There's no money in it so you're not getting any visibility. Bankers will put up research, but the research sits on the shelf and isn't marketed so there's no liquidity. We're going to talk about this.

These are the papers, I won't belabor it, some of the papers. They were cited in the IPO Task Force report to the U.S. Treasury, cited in the interim report by the President's Jobs Council, Jeffrey Immelt’s job council to the White House. We've spent some time with the U.S. Office of Science and Technology policy in the National Economic Council, among others.

I'm going to very quickly give you a quick primer on some-- a little geeky but I think important market structure concepts, and this is macro 1995 versus 2012. We had large-cap stocks that were largely subsidizing liquidity in small-cap stocks. It's not me saying that, that's having conversations with Dick Grasso and with Richard Bernard who is the former general counsel of the New York Stock Exchange.

We had retail sales in the United States, brokers that got on the phone and marketed securities. Today they're mostly portfolio managers allocating assets because of the change in the compensation model. We had 100,000 stock brokers turn into 100,000 stockbrokers that were liquidity creators turned into 100,000 asset allocators.

Broad institutional coverage versus narrow institutional coverage, and I can tell you when I go in to the syndicate desks of the Wall Street firms there's about 60 accounts out of 3,000 institutionally disclosed that generate about 90 percent of the commissions. The top ten institutional accounts of the bulge bracket firm, I know from the head of research, generate over $100 million a year in revenue from things like prime brokerage. A good $20 billion name brand mutual fund has confided in me that their biggest commission paying relationship on the Street is $2 million. They're not getting attention.

What's happened is, again back to the flesh-eating bacteria concept, we've eroded distribution in the United States, the ability to reach the so-called long tail of the distribution curve. This is one of the reasons why you're going to see that we're not doing the number of IPOs. It's an aftermarket and distribution support problem that's been complicated by penny ticks.

We have a notion and a fundamental research analyst add information into the marketplace, they add a view, and increasingly, when you create hyper-efficient markets and things that are overly dependent on derivatives, exchange traded funds are derivatives, we bias the market with computers and information mining strategies that look through the rear-view mirror and the rear window.

Now that's really problematic and probably partly one of the reasons why you're seeing such enormous correlations across industry groups. Some people say the correlations can be as high as

80 percent now. We're interfering with the market's fundamental ability to price individual stocks.

We talk about now fundamental versus technical skills. I just mentioned that. Non-correlated markets, it's versus correlated. Then finally, on the micro side, there's this notion of-- and this is important, very big difference between how a large-cap stock trades with symmetrical order books, where there's lots of buyers offsetting lots of sellers.

The Intels of the world, the Exxon Mobils of the world versus the typical thing of a small micro-cap, nano-cap stock, small-cap defined as sub-$2 billion of market value. Micro-cap institutionally under $500 million and nano-cap under 100 million. That these things are frequently, the natural state can be asymmetrical meaning big buyer, no seller, big seller no buyer.

Who steps in the middle to create liquidity? The answer is, today, no one because you can't get compensated to do that, and so as a consequence the institutions take their liquidity thresholds up. They can't pay enough for the Street to cover them, so they become increasingly self-directed. You've got the vast majority of institutional accounts out there today that really aren't effectively covered by Wall Street.

We can talk about the difference between quoted and unquoted markets, but let's just say that we had-- and Jeffrey's probably going to be better at this than I am. But the idea, before we got into Reg ATS where people created electronic order books is that we actually had kind of a hybrid market where you had instant trading in smaller tick sizes. But the quote increments were fatter, they were quarter point spreads.

As a risk manager on a trading desk, you could effectively work an order as a quarter point and you could put the stock back out, buy it at ten, put it back out at ten and a quarter so you'd make two and a half percent on the execution. People would buy these blocks of 100,000 shares, in at ten, and then they would work off, make phone calls and sell it out in 1,000 share increments all day long because there was adequate incentive to create liquidity and visibility on a stock that you might have a buy recommendation on.

Then that's the notion between what I like to call-- again, this is Weild terms, these are not academic terms-- that tick sizes versus effective tick sizes. In those markets, we had higher effective tick sizes than even the actual minimum stated tick size.

Moving ahead-- wrong way-- what I've gleaned in the aggregate, and this is again short-term event driven sort of analysis, not just in the U.S. stock markets but in foreign stock markets as well, from the academic papers, illiquid stocks are harmed by smaller tick sizes. If you've got an already illiquid market, you're going to make it worse by proliferating ticks. Liquid stocks, however, tend to be helped by smaller tick sizes.

I ask you if you've got already liquid stocks and you're saving investors' money, that's the one positive thing you're doing for the market. But you really haven't helped market quality on the average if you're making already liquid stocks more liquid?

Again, what is the long-term effects of smaller tick sizes on the ecosystem defined as the research, sales and trading, all the on-ramps into the stock market, the manufacturers? The answer is, they degrade stock market infrastructure capital formation and undermine the economy.

Now here is a quote from the cofounder of Knight Securities, Walter Raquet in 1997. It was a letter to everybody at the SEC. And he said, “remember, you are tampering with the most effective capital raising and job creating mechanism in the world, the NASDAQ stock market.”

Here's a quote that recently appeared in Trader Magazine, and from Bright Trading. And this fellow says, “I think many of our problems with market liquidity and small and mid-caps can be traced right back to decimalizations, ticks sizes,” said Dennis Dick, prop trader at Bright Trading in Detroit. “Where decimalization has helped to reduce spreads in the large-caps space, it has actually harmed liquidity in the small- and mid-cap space.”

So here is a guy who is a practitioner saying exactly what the academic literature, at least that I've seen, bears out. “For blocks, it's nearly impossible to execute any sizable order without significant price impact,” Dick said.

Now Larry Tabb, for those of you who don't know, something called the Tabb Group, which is a research group that actually has a pretty big high frequency and alternative trading following. And to me, the shock of all shocks is when Larry, in an article in Trader Magazine Online News on June 1st comes out and says, "the dime spread shouldn't be off the table and considered as well. This," he said, "would incentivize brokers to trade and provide research for smaller and new companies. I mean, that to me is amazing.

“Professor Angel believes issuers not the regulators should decide what the spread should be in stocks. But if a company trades better with sub-penny pricing then sub-penny should be permitted.” Again, back to the original premise.

Now here's a construct that I put together which basically is answering the question, what do you need to make markets work? You can apply this to private markets, you can apply it to public markets. What you have here is I’m mapping each of the titles of the JOBS Act, actually the original bills that then became part of this omnibus act, which is the JOBS Act, to what they've really done for the market.

We believe that you need three things to make stock markets work. You need standard disclosure. Think about the Reg D private placement market. There's no standardization of disclosure. That's going to impede development of this market.

You need reasonable cost for issuers. Can’t be confiscatory. So when you're looking at micro-cap markets, if it's too costly to stay public, people will start to go private. If it's too costly to go public, they won't go public. It's very important.

You also need an adequate after-market incentive to provide support. The JOBS Act, in every single one of these areas right now is failing. If you think about the after-market incentive, the structure, Reg D aftermarkets are subject to blue sky. The aftermarket is very unclear. Same thing with Reg A, there's supposed to be a study. We had a little bit of discussion earlier about crowdfunding and the aftermarket there. Now in the public markets, because we're trading in pennies and sub-pennies, if you're looking in dark pools. There's no money in the business to create liquidity and support the aftermarket.

The disturbing part here is why this discussion is great. The improvement in the on- ramps, if you will, is great. The mitigation of some of the costs is great. It's a great step in the right direction for job formation and for the U.S. taxpayer and I commend people for it. We've got to fix the aftermarket support machinery if we really want to put fuel to the JOBS Act and deliver what Congress intended, which is a ramp-up in innovation and job growth and liquidity. We're going to talk about this a little bit more.

Here is one of the slides updated that has been passed around in Congress and over at the executive branch of the White House as well. The blue tranche is sub-$50 million IPOs and the orange tranche is larger than $50 million IPOs. On the far left-hand side is 1991, the far right is 2001, and what you're seeing here, if you can see where the drop-off is, it's right there with the implementation of Reg ATS, alternative trading systems.

We took all these limit orders and we actually cut up tick sizes effectively in an electronic order book environment. What you're seeing in the drop-off of small IPOs is that the aftermarket economics went from being profitable to investment banks to costing them money. They pulled out of the market. This is sort of the proverbial canary in the coal mine. It never recovered. Never recovered. Used to be 80 percent, 70 percent of the IPO market. By the way, if you inflation-adjust the numbers here-- people ask me that question all the time-- it's not that much different.

Here is a ham-handed way of just mapping tick sizes, if you will, to the same map, and you can see that it's pretty highly correlated, maybe not in a scientific fashion, but using reasonable man standard to the degradation in the small IPO market.

Now again, this was one that was put up in the House Financial Services Committee. What we did was we took that data from the World Federation of Stock Exchanges, we were the first to do this, and looked back at how the number of publicly listed companies has changed, indexed to that period in 1997 from the prior slide here.

What you see, when the rule changes started to come in earnest. What you see is that the United States has lost listed companies from the public markets every-- and I'm talking about C-corporations. We took out the funds, the noise if you will from the markets. These are operating companies. We have literally lost listed companies net every single year since 1997. Every single year.

The number of IPOs that we estimate that it takes just to stay even through market cycles is 360, which is a number that we haven't seen since the bubble burst. We predict that you're going to continue to see a decline in the U.S. public listed markets. Interestingly, we've got the worst record in the world right now of the countries that we could get data for. But I would say that, as people emulate U.S. stock market structure, it will start to erode.

We had a higher base to fall from, because we had major retail involvement in our markets through these higher spreads and commissions in the United States that a lot of other markets didn't enjoy. We had a competitive advantage, if you will, in capital formation, and that has been absolutely destroyed lock, stock and barrel by this application of one size fits all market structure to micro-cap, small-cap names.

This is what disturbs me, is that if you can't get companies public, it's going to create a domino effect that ripples right through down to the start-up community. I already know that it's been tougher for venture capital funds to raise successive funds, that there's been a diminution in the number of funds. We've got other people coming onboard, the angel community and so forth, and obviously the crowdfunding.

But if you can't get the IPO markets to be supported in the aftermarket, okay, then ultimately you're going to reach a limit here, a ceiling. We're not going to do the wonderful things that we want to do to engender job formation and a resurgence of the U.S. economy without fixing that problem.

Here is an analysis, and it's a little bit of an eye chart, but let me tell you what we did. This is the actual number of IPOs, the dark gray tranche. What we did was-- and you can see that if you get into the 1998 forward, the numbers decline. 2000 it drops off of a cliff here-- from which it's never recovered.

You look at these little years here, those are the bull market years when the market was really trading up and we should have an echo boom from. There was massive amounts of venture capital, unprecedented, that were raised here. We should have had a venture fueled IPO boom during this bull market period that was unprecedented in terms of numbers of IPOs, and this thing just absolutely whimpered, never came through. That's because we'd already done all this damage to our aftermarket support model.

Now what we've done here in terms of these two ranges is we've said-- and this is some economists have told us to do this-- if we assumed that we never changed market structure and we compounded the number of IPOs, the lower limit in 1991, the lowest number in 1991, and the highest number which was 1996 and established the range, we could project out at three percent GDP growth rates how many IPOs we should be doing.

As you can see here, that's the range. It's a much bigger number than we've been billing.

This is the delta here, and when we calculate-- and this is using Professor Ritter's sort of numbers from the University of Florida, what we find is that, at a minimum, without any improvement to the private markets-- remember we believe that if you get more companies public, more people invested in private companies will create a lot of jobs in the private market. Without any private market effects, that's a 3.1 million to 6.2 million job effect.

But if you double it, because we think that the number, the contribution to the private market would be even larger because you're giving people a shot at the American dream, this is what we're aspiring to. Nothing better than a big visible successful IPO. We could see job numbers in the

9.4 million to 18.8 million range. Suffice it to say that a big part of the job problem in the United States is because of what we've done to destroy the aftermarket support model of capital markets.

This is just a little bit of economics, and this is from the practitioner's side. This shows you how a $25 million IPO would be priced out from an equity syndicate investment banking perspective. The only thing that I want to tell you is that today the analysis is you're giving back money as a book running manager in the aftermarket whereas that $25 million IPO used to triple your profitability in the aftermarket.

Think about it. You're not in the business to lose money. If you're going to provide support, you're going to get to the minimum you can do to satisfy the interest of the management team, and the management teams typically are not sophisticated enough to understand that the research on that micro-cap name is not being marketed. It's just sitting up on the shelf. It's not actively creating visibility.

So somebody comes in, wants the models, if they're an institutional investor they'll get the models. If they're a big institutional investor, they'll get to talk to the research analyst.

By the way, when we do checks for management teams on who the likely buyers are based on account targeting work that we do, we call them, we find that 80 percent of the likely buyers of any IPO are-- they do not have a relationship with any of the research analysts that are covering the vertical. Think about that. That just tells you how fractured the distribution model on Wall Street is.

Now here are some sort of life signs, if you will. Looking before 1997 and after 2001, tick sizes have gone from effective-- remember I say effective tick sizes of a quarter point-- down 96 percent. You've lost 96 percent of the economics. I mean, what industry can survive that kind of change looking the same way over time?

By the way, people don't react instantaneously. You don't want to fire people. I ran research sales and trading strategy at Prudential Securities and Banking. People, they are in denial when these things happen. It takes them years to adjust, they cut compensation first before they cut bodies. Then ultimately-- and when we went through this exercise when I was vice chairman of NASDAQ, because it took me a long time to convince the executive Committee that, in what I like to call the bubble rubble, that people were going to start pulling out turrets and information, data feeds, and then our numbers were going to come under pressure. This is real world.

Investment banks, I mean, if you look at the number of investment banks that act as book running managers, and we took a 1994 number which was before the dot-com bubble, and we looked at an after 2001 number, which was 2006, a bull market year. Remember, there were more IPOs in the early '90s than there are today. So that skews the numbers upwards. But in the post-decimal world, we now have a practice of multiple joint book running managers. That inflates the numbers on the other side.

You've got 167 book running managers in 1994. This is different firms. And you're down to 39. That's an ecosystem. I mean, we're down to 39 in a bull market year.

Small company IPOs defined as sub-50 million, we did 2,990 in a six-year spread from '91 to '97. Then including the bull market spread, 2001 to 2007, we did 233. This market doesn't work. It's an aftermarket problem.

Now this is one of the reasons why your IPO windows are shutting. IPO success rates, this is evidence of systemic failure. It's a simple linear regression, I showed this to Mike Peowahr who's the micro markets Ph.D. for Senator Shelby. He said, because he nit-picked on my math and my approach. But he said, yeah, it's pretty clear that there is a trend here. He gave me that.

[Laughter.]

MR. WEILD: What you've got is-- you had 1993 on the far left the way we define a successful IPO is sort of happy outcomes for senior executives, for CEOs. As the deal gets done, within a year of getting filed, it gets done at or above the original low end of the filing range. If the deal was filed at $10 to $12 a share, it's got to get done at $10 or higher. It's trading at or above the issue price 30 days after the offering.

On that basis, we've gone from 57 percent or so of IPOs being successes to about 27 percent. And other than that, Mrs. Kennedy, how was the motorcade?

Now we have IPOs greater than $500 million. There's a lot of this pablum from the bulge bracket firms, do a bigger deal, do a bigger deal. Well, it fits their economic model, but they're not doing better than the others. This is a 30-day trailing average of larger than $500 million IPOs. Look at the trend line, folks.

Now people ask me, well of those three criteria, what's down? Well interestingly, 30 percent more of new issues are breaking issue price 30 days after the offering. So a big part of this, the reason why these windows shut is because people aren't making money because Wall Street can't price deals. Wall Street can't price deals, because they can't afford to cover critical mass numbers of real investors and support these things in the aftermarket.

This is that data. You can see that a big part of it is deals breaking issue price.

Now, when we look at just kind of the common sense, who are the winners and losers with this market structure, well clearly, winners over the last 15 years have been speculators, big investment banks, hedge funds, day traders, electronic trading, volatility, trading oriented institutions, dark pools, big company acquirers, Asia. Asia's doing better than we are.

Losers? Small companies, entrepreneurs, private enterprise, small investment banks, venture capital, market makers, stockbrokers, new issue distribution, equity research, IPOs, institutional liquidity in small-cap stocks, transparency in small-cap stocks. Why do I say that? Fewer information providers. Long-term investors, the United States.

I'm just going to go right at the heart of this from a public policy standpoint, and I have a-- what you have here is-- and you can't read it, I apologize, it's a bit of an eye chart. But we have broken the data down. Nano-cap companies are on the far left, which are defined as under $100 million. The next is sub-$500 million equity market value companies. The next, with a white line is the small-cap sub-billion. Then mid-cap is to $10 billion. And then I got large-cap on the far right-hand side.

To the left, which is the sub-$2 billion market value companies, you're dealing with literally only 6.6 percent of total market value. But it represents 80 percent of all listed companies. I would tell you that there is no small-cap company that's represented a systemic risk to the U.S. economy. But what we do by overly burdening small companies from a cost standpoint, by inadequately supporting them with higher spreads and higher incentives to drive down their cost of capital, is that we create an environment which doesn't support innovation, economic growth.

I put Paul on the spot here, but Paul, when I got into the business, the venture capital industry took over 50 percent of their exits were going out IPO. I mean, it was a big chunk. And today what I see is over 90 percent seem to be going still exclusive sale M&A. Is that fair?

MR. MAEDER: It's absolutely fair, and it's a disaster. Because it affects M&A pricing, too. Because the buyers-- there's an oligopoly of buyers, they just sit and wait until the companies run out of money and then they pick them up for nothing and the jobs are lost. Because when big companies acquire start-ups, they get rid of everybody except a few technology people who usually leave after a year anyway. There are so many pernicious side effects of all of this.

MR. WEILD: By the way, it's not limited. When you look at the distribution of companies from source of origin, it's not just the venture guys. No small companies are getting public, so you could have a 20 percent growing, beautiful Virginia ham company that was bootstrapped by mom and pop investors. If it's too small, it's not getting out.

Some of the big-cap bulge bracket firms-- he's no longer at General Atlantic, but I had lunch a while ago, he was running ECM, global head of ECM for J.P. Morgan, is David Topper. David had said, he let fly one day at a lunch that you needed $500 million in float to sustain interest in a stock given where these tick sizes were.

I want to implore you, this is how I look at markets. I want you to share this view of markets. It's not about the New York Stock Exchange. It's not about the guys that actually connect traders together. It's the broader ecosystem. This is infrastructure, this wonderful mechanism that we've created. Every bit as important as bridges, roads and tunnels.

But the infrastructure includes the small broker-dealers that really do the gods' work of taking companies public and supporting them in the aftermarket. If they don't have a viable business model to make money in the aftermarket, man, we're all lost. This thing is going to continue to erode and we're going to continue to put people out of work.

Here's a quickie. This is Microsoft's IPO. $58 million, it was done in 1986. This is the group of managers or underwriters, and every one of those ones in yellow is gone, it's not in the equity underwriting business any longer. Here's your LinkedIn IPO in 2011. It's six times larger, it's got five big firms.

Now we put up at NIRI and had a show of hands, and I think they're socializing this so you're going to hear more. I think that part of the issue is in the governance, and I don't think the managements are very good at understanding the connection between market structure and cost of capital. They don't do a terrific job advocating for themselves. I think that one of the unintended consequences of Reg ATS is it unleashed a whole new series of competitors that were trading only. They didn't have the responsibility of the New York Stock Exchange or NASDAQ to defend the interest of issuers.

Back in the days before exchanges were for-profit entities, we had sort of three seats at the table, it was institutions, it was the member firms, and it was issuers. We basically did a-- it was a part of our duty to make sure that there was a balancing of interests.

The unintended consequence of opening up a competition through Reg ATS and NMS to all of these trading only organizations is they descend on Washington, and they campaign, and they lobby, lobby, lobby, lobby. Issuers who were really inept, for the most part, at understanding market structure and its impact on corporations are basically crowded out of the discussion and we end up where we are.

We've asked for-- and this was voted. By the way, this was not something that I came up with, it was the whole panel at NIRI. They're looking for equal standing and for issuers, representation, standing issuer advisory council to the SEC made up of issuers and issuer advocates. Transparency, timeliness and completeness, because they don't know who the heck's trading in their stock half the time, okay? Choice in market structure, no more one size fits all market structure and market structures that encourage fundamental investment strategies over trading strategies.

Finally, I wanted to float this idea which is that we really believe that issuers—you could put -- it's really very easy to do when we socialize this with a number of people that are actually in the trading venue. Allow issuers to choose their own tick sizes through some tolerance or some range.

It gives them a seat back at the table, it forces them into a discussion with their institutional investors, it forces them to have a discussion with their value providers who are the investment banks. Market forces will, if they're out of line, will exert pressure on them and they'll be forced to take their tick sizes down.

It's a pretty simple bits and bytes kind of exercise. Wouldn't cost money, and I think that you'd be amazed at how many jobs we'd start to create in the U.S. markets. We'd start to get companies public again, we'd start to support them, people would invest in research, sales and trading. I think it would take a while, but happy days would be here again.

The idea is that you're under-funded, and-- in this segment of the market. If you don't fix the problem, you're not going to see-- I mean, the top in the new cyclical highs of the IPO market really run around 200 with this market structure. That's the upper limit, and you can do the delta of what 360 new listings required a year just to maintain homeostasis, equilibrium. You're going

to continue to shrink these markets on average for the foreseeable future.
Thank you.

MR. YADLEY: I feel a lot better, David. Thank you.

[Laughter.]

MR. WEILD: Oh, and let me say -- and I'm going to bring these-- I wanted to read into the record. I have three letters, the third one, I-- they sent me a replacement, but they were from the senior managements at Cowan and Company, Think Equity and Piper Jaffrey. They're all imploring us to raise tick sizes. They're all fairly similar.

This is from Jeff Solomon. I'll just read one, and then I'll get them out to you, Jennifer and Lona, so that you can distribute them in electronic version. "Members of the Committee, as Chief Executive Officer of Cowan and Company, mid-size investment bank that focuses primarily on the growth sectors of the economy, I am writing you in support of increasing the tick size from a penny per share for emerging growth companies and other small-cap stocks in order to increase the potential number of IPOs for these companies and enhance liquidity for the trading of these stocks.

"As I know you're aware, recent studies have shown a correlation between a reduction in tick sizes and the number of IPOs in the United States markets, less than 50 million in gross." He's citing our work.

But it goes on, "the SEC has the ability and opportunity to increase the liquidity for these stocks by appropriately increasing the tick size for EGC and small-cap companies. I recommend allowing each small-cap company to set its own tick size, but I think that the range of five to ten cents per share would be reasonable. By increasing the tick size for small-cap companies, investment banks would be appropriately incentivized to provide increased aftermarket support for these issuers by committing firm capital to support market making in these securities.

"Let me be clear, the capital commitment is not proprietary trading, it is merely ensuring inventory is available to provide liquidity to customers. Increasing the tick size would also make it easier for an investment bank to commit more resources, including research coverage to small companies, thereby increasing the ability of smaller companies to access the public equity markets. I know first-hand the economic disincentives investment banks face in taking small and mid-cap companies public and supporting them in the aftermarket. Plainly, our ability to generate profits from trading and otherwise supporting these companies has eroded.

"Cowan, along with others like us, has had to focus more resources on trading larger cap, more liquid securities and we certainly recognize that this necessary business decision, under the current regulatory regime, has exacerbated the lack of liquidity for small-cap companies making it more difficult for them to contemplate IPOs."

It goes on. We'll get those out to the Committee. But there are three of them and some of them cite specifically the order handling rules, Reg ATS and decimalization as the culprit.

But my point is that these guys are the ones that are actually in the business of supporting micro-cap names. They are not derivatives players, they don't hold dark pools. One of the problems you have with tick size is watch the rebates and things that go on in dark pools, because people can disintermediate. The intent, you want to get economics into the hands of people that are actually going to invest in the ecosystem.

I think I'd leave that up to smarter minds than me, but it's very clear that if you don't do something, the stock markets are going to continue to erode. Thank you.

MR. NALLENGARA: I know there's lots of questions, but let's turn to Professor Harris and then we can all talk after, if that-- I think you may need this.

DR. HARRIS: Sure, thanks. I've been involved with this actually from way back, so we'll talk a little bit about my research and a little bit about what we know about the market structure and these sorts of things.

A little bit ironic, I think there are some other issues involved with providing economic incentives and how economics are made in small-cap markets. But we'll talk a little bit about various components of this. Here's just a brief overview of what I'm going to talk about. Basically, a lot of this drop-off in IPOs is not coincidental with the bursting of NASDAQ bubbles, so we've done some research there. Of course, some of the research I have on this subject is the disproportionate effect on retail traders.

I think David's point where there's some economic incentive required is a little bit predicated accordingly on the participation of the people who are going to buy these shares as well. I think generally speaking, some of the stuff I'll show you today, a little bit disproportionately affected the retail trader and the reluctance of retail traders, I think, to participate in these markets is another component in the dearth of IPOs recently.

The other part, I think, is the demographic shift. We see a lot of people, of course, in the baby boom that were more than happy to invest in IPOs in their 30s and their 40s, got burned during the IPO bubble and, of course, now have shifted into fixed income products as they approach a retirement. There's a demographic component of this as well.

Then sort of based on some of Jay Ritter's work as well down in Florida is that these typically small-cap IPOs haven't been very good investments. We have a repeated game problem, I think, for getting people to participate in these markets again as well.

Then I just want to briefly review, because I have some research on this, too, but I think the investment banking community has got to share a little bit of the blame here, in the sense that there's been some pretty high profile scandals or alleged problems in these markets where the investment banking community has sort of caused some of their own perception problems in discouraging investor participation in these markets.

We're at the SEC and of course you can't mention anything without the increased regulatory burden. Part of that might be the tick size, other might be reporting requirements and other components of the regulatory regime. Then, of course, the concurrent tick size changes. There are some evidence around the world that small-cap IPOs have been problematic in other countries. The AIM market in the U.K., the small-cap market in Japan have all failed, basically, and they didn't do anything with their tick size. There's some international evidence that suggests there tends to be a worldwide phenomenon of reluctance to invest in small companies, whether it be the risk or the historical returns for these particular stocks.

This is just another snapshot out of Jay Ritter's stuff, and you can see the same thing David pointed out. There's been the big drop-off. But I guess one of the things, I extended this a little bit more to go back into the early '90s. There have been times of cold IPO episodes before that had really nothing to do with tick size changes. This is something we look at as research to find out, can we pinpoint-- I don't think anybody really knows. One thing that we do know is that IPO markets are flourishing when markets are going up. The other thing we know is the stock markets in the United States haven't gone much of anywhere for ten years. That's been the issue, I think, again of attracting basic demand in this marketplace.

Then I just pulled off this from Jay Ritter's papers again, looking at sort of like the buy and hold return or market adjusted returns or whether it's venture backed IPOs, and things like that over various time periods. Sort of the buy and hold returns of these sorts of things in the '90s was pretty good on a normative level. But if you market adjust that, all these returns are pretty much negative.

Historically speaking, of course, that generates some skepticism from the investing public. Now it could be that there needs to be more incentive for people to say, well look, we have in the 2000s at least, on average, been positive. Maybe we've come back to an equilibrium where investors or investment banks have a better story to tell. But that story I don't think has been out there very clear. I think the larger people that I talk to in the investment community suggest that, well, these haven't been very good investments and they point to this historical evidence that isn't recent data.

Then if we go by size, it actually gets worse. If we just break this down from Jay Ritter's data, like the market adjusted return for the smallest micro-micro-cap of these IPOs is actually worse than anything. Again, we have a series of repeated games where we're coming back to the same investing public and asking them to try to invest in these products and saying, well here's the historical returns. It turns out to be a little bit more than just the problem, I think, of generating revenues for the investment bank. But also trying to get people to put their money into an investment pool that historically has under-performed.

I mentioned we did a little bit of research. This is something we pointed out, I spent a year at NASDAQ and I spent the next six years actually collecting a bunch of NASDAQ data. We got data from different market making firms. This is just plot of the net buying and selling around sort of peaks in stocks. What I've graphed here in the solid black line is just like an event study, and it is a short-term thing, like David said.

But it looks at the events of markets going up and how quickly during the bubble individual stocks turned around. We just lined up and put the peak day of every individual stock and marked for the days before that and the days after. We just plotted, it's a couple things of interest. On the way up, as these markets were going up in the late '90s, pretty much everyone was buying. Institutional traders were buying, retail traders were buying, discount brokerage clients were buying. There's basically a broad sense of, of course, over exuberance or something, you might call it. But there's a general sense there.

Then add the key component, I think, for me, I think for a lot of people in the IPO market is what happened afterwards. In the aftermarket, what we found is when these markets were peaking, institutions were very adept at getting out. That's what I have on the pink line there. You can't see it, but I put the little line in pink.

Those are institutional clients, the major institutions, Goldman Sachs, Morgan Stanley, major institutions that are representing clients. They got out of those particular stocks right away. If you see the pink line, it reverses actually the day before the actual peak of the market. The institutions have been very adept at getting out of this.

I only make the point to make the comparison between what happened when we look at discount and retail brokerage accounts, it's a much different story. Here's what happened for full-service brokerage. That's just in the blue-- or the brown line there.

We saw a little bit of an uptick, we see them buying into the peak of the market and then, as the market was collapsing, they kept buying. Retail traders actually buffeted the drop in the NASDAQ bubble. The downside of that, of course, is we stuck a whole bunch of retail investors with stock that continued to go down, or at least held stock that at the end of this decade that almost went nowhere. As these markets collapsed, the retail traders actually were disproportionately affected.

It gets a little bit worse on the top line there, which these are discount brokerage accounts. Some people actually made the claim that we should somehow limit people's ability to trade. The discount brokerage clients actually made bigger mistakes. When the market peaked out, they said, oh, Pets.com is at 80. Oh, it goes to 60, let's buy more. Oh, it went to 40, let's buy more. And of course, ended up going bankrupt, and they held even a disproportionate number of shares in those accounts.

Now the question there becomes, are they trading too much, is it irrational, should we increase trading costs to try to discourage this sort of thing? Should we have some sort of model that does this? But I think this is important for the context of the IPO market, especially in the small-caps because I think the broad IPO market requires a broad sense of market participation among investors.

Where do we go with the public perception? Of course, investors-- one of the things is we could say we could buy access to the initial day returns. We have this brand event where we go out with an IPO, the market pops up, everyone's happy, we make 15, 10 percent during the first day of trading, we hold on to the share. David mentioned some things where it's been an historically weak environment over the last five, ten years in the aftermarket.

But this is where the scandals sort of took place, back in some of these settlements that we've had with the SEC as well. We have commissions where people say, yeah, I bought access to the IPO and it's come out--, I paid my broker more money on the side for other trades that I do for getting access to the IPO. We had laddering involved, we did a paper, I think included in your materials, that looked at underwriters basically co-opting the process of aftermarket support and pre-contracting before the IPO went public to giving favorite access to people who were committing to the aftermarket.

Now technically speaking, that's not illegal if it's disclosed in the prospectus, but the question then becomes-- it creates a public perception, I think, of the IPO market that is not fair, that somehow somebody gets access that I don't. It's because of these side deals that are done on the side. Then, of course, the spinning requirement sort of allocating hot IPOs to the CEO and buying sort of favors, and that's-- in that sense.

The other part I think that the investment banking community maybe has to take some responsibility for is its conflict of interest policy that there's some investment, high profile again, saying we need to promote the stock. We're buying the stock but on the side selling their own stock out of their inventory privately. Of course, creating the image, at least the appearance that it's not a fair market.

I think these are some of the things in the public that are characterizing whether there's a strong buying demand for providing risk capital and its funding for small-cap firms.

I just pulled down a couple of these-- I'll just run through them quickly. The VA Linux IPO popped. Of course, that was a huge pop. It went from 30 to 240 almost on the first day of trading.

CSFB, and some of the settlement stuff that they have with the SEC here, they readily admitted to some of their clients that they mature. They were willing to pay $0.50 to $2.75 a share and commissions off the side to get access to this particular IPO. The laddering, we've done a study on that showing that it doesn't seem to have any economic basis, it just has something to do with, again, maybe a move away from the economics of the situation and into the favorite access category.

Then I just put together a table of Bernie Ebbers', of course, high profile cases. Well, in the number of IPO shares that he was allocated-- and all these things come out in the public and this has long-term, I think, ramifications for getting the investing public to be involved with an IPO market again. So, Bernie Ebbers himself was allocated all these shares individually, before they went public with WorldCom. Of course, we know what happened, WorldCom blew up.

But again, it creates the perception from the investment banking community, all these things that it's not a fair and unbiased market, and why should I participate as a retail investor if all I'm getting is sort of the wretched refuse or not getting access because somebody else is buying access or, they turn out to be bad long-run performance in the long run.

Those are just a few things. I call it the hangover effect. Retail investors are burned disproportionately, more-so for discount brokerage accounts. I'm not sure what we can do about that other than caution investors. I think as the investors' advocate, the SEC I think needs to be careful with some of this.

When I was at the CFTC, I know we deal with derivatives, and I would do talks about whether people should get into oil and gas markets. I said well, there's absolutely no insider trading rules there. My advice is stay away. But now we have ETFs and other things. I think there's always this cautionary role that the SEC can play in educating people about what goes on in these markets.

The relatively poor long-term returns, that's a big question. Like historically, they have been bad investments. Then what do you do now that the public perception is that they might be bad investments and how do we convince the investing public to ante up to the table? That's a big problem.

The high profile scandals that have been out there, and then I've talked to a number of individual investors and people on the Street and they said they just have a reluctance-- they have a hard time selling these things. Part of it may be the revenues that they developed in the investment banking side, but the other side is just that there's no demand there. It's not worth the investment banker's time to go out and try to sell this issue because there's nobody on the other side of the phone that's going to say, yes.

The other part I think in the macro sense is the competition for IPO dollars. We talked a little bit about mergers and acquisitions with small-cap private equity market, but there's also bonds, ETFs, we talked a little bit about the demographics and people shifting away from the stocks as the baby boom gets older. These mutual funds and real estate and all these other types of assets that have come into play.

If we're comparing sort of apples to apples where investment dollars get allocated, it would be nice to have them in growth start-up companies and small-cap firms. But again, if those small-cap firms have historically under-performed, it's going to be hard then to convince the investor set to put their money in that segment.

The market structure I think is a little bit more interesting. Back to what David was talking about, Easley and O'Hara basically have a paper and there's a bunch of actually historical papers that talk theoretically about how we actually encourage participation. One of the great components of the U.S. market, of course, is the demographics of retail participation in stock markets.

If you look around the world and you look at other developing economies, one of the problems they do have is whether it's enforcement of laws or rules, or the abuse of insider trading or insider information. The United States has always been at the forefront of that in developing strong capital markets.

The reluctance and the reputational problems, though, have real economic factors. If we have an environment where people don't trust the IPO market, then this lack of participation or the uncertainty that they're facing by putting their money in this market actually discourages them from participating whatsoever.

From their perspective, I guess, in this particular paper, they-- you get fewer IPOs when you end up with listing fees that are high, on a relative sense, right? Other fixed costs are high. That might be actual direct fees to your underwriter and it might actually be Sarbanes-Oxley type fees and things that you have regulatory compliance costs.

Then of course, the perceived difference between sophisticated and retail investors is high. I think that's something that's changed over the years, that this perception from the retail crowd that sophisticated investors have preferred access or they have better information sets or they have a better ability to get in and out. We do see that at least in the data, that there's been differential behavior. If there's that difference between sophisticated and retail traders goes up, that discourages from the retail traders from actually participating further.

Of course, then it all translates into the potential for small IPOs because all these fixed costs and everything rolls back into bigger as a fraction of the actual issue in the small IPO market.

The decimalization issue and declining spreads, it's interesting because most of the research in academic circles on this thing says, well, if we have smaller spreads, lower transaction costs should feed back into lower cost of capital. Lower cost of capital should lead to higher IPOs. It's interesting. There's a couple-- one paper way back, Brennan and Hughes basically shows us that the relative tick size enhances brokerage commissions. This is back in the days of stable sort of market spreads.

They basically said brokerage commissions and the trading of these securities is going to generate commissions that provide the liquidity. Jim Angel, like we discussed earlier, he's up at Georgetown. Basically he wrote another paper that said optimal tick size should be some sort of enhancement of market making profits. Whether that's the spread transaction that we have, so it's more general than just commissions. But it could be the spread revenues as well.

And of course, Paul Schultz at Notre Dame, one of my co-authors as well, had done a study basically looking at some of these same issues. Not in the IPO market, but looking at stock splits and show that there is some sort of preferred habitat of having a ratio of the tick size to the price that provides some economic incentive for purchasing and selling some of these things in the market.

I think David pointed out, some of the spreads have dropped precipitously from about 30 cents per share in 1995 to 2001. Here is just a picture from my days at NASDAQ. The blue is just all NASDAQ issues from -- what do I have, 1995 up there until 2001. I didn't plot it out in this decade, but you can get an idea for the size. We dropped down from 30 cents down to under a couple pennies in this particular case, we're down to pennies on average in today's market. There is a real structural shift here.

The question then becomes, does that actually translate in? Once again, one of the issues of this is-- one of the source of the order handling rules in 1997 is the collusion settlement with the NASDAQ underwriters, or the market making set. There was a $1 billion settlement for collusion lawsuit about keeping spreads artificially high. That's again a reputational problem I think that some of the investment bankers have to face.

If we're going to reboot the IPO market, then where do we come to solutions? I think David's got some ideas. I think there's some other ideas on reducing fixed costs. I think some of these things should be on the table as well. There's whether we should revisit Sarbanes-Oxley and some of the requirements for reporting and fixed costs of-- that that imposes on small firms. I think there's some research back in the early '90s on bulletin board disclosure over-- OTC bulletin board disclosure requirements that had a deleterious effect on listings in general. There's been some studies on firms going dark, firms delisting that are international firms that used to list in the United States that are, based on the regulatory requirements, not doing that anymore.

Of course, trying to reassure from the SEC's standpoint the retail investor crowd, settle on sort of rules that reduce the ambiguity. I think Dodd-Frank in general has created some uncertainty. I for one, when I was in CFTC, was hoping we'd have Dodd-Frank a year ahead of us. We ended up doing health care a year ahead of the financial reform. I think we would have all been better off if we would have tackled the financial issue first, but we can't go back and do it now.

But anything we can do, I think, to reduce this ambiguity or the uncertainty of retail investors in this marketplace would be good.

And of course, engaging the venture capital community to find out what is the real source? Do they see any demand? What are the other sources of problems of putting these market-- small growth firms out instead of going to the M&A market. How could we better connect with the investing community?

There are a couple other things sort of on the side. One of the ideas that's been floated, I think, before the SEC before, and one of my colleagues at Syracuse is Anand and Tangaard, we have a paper out looking at payment for liquidity.

It's a little bit related to what David as talking about, it's a liquidity provider where a firm, an issuing firm could actually pay for a sponsorship and just say, I want to have a market specialist in my stock to stand ready to buy and sell. I want that liquidity to be available, so I as a company will be willing to ante up and pay that now.

It opens the door for some agency problems, but it's being done in some of the Nordic exchanges, and they've done a study actually on that. I think NASDAQ has a proposal, or had a proposal in front of the SEC that's been vetted around and worked through. It's some of the same idea, trying to provide some economic incentive. This is a sort of alternative, instead of worrying about the tick size, its maybe we can just have a payment directly that remunerates somebody for being willing to stand ready to trade.

Those are the things I have to say. I think this is an interesting topic. It's not an easy topic, of course there's a lot of moving parts. It would be nice to be able to say that we could somehow wave a magic wand and have these markets opened up and start trading again. I think the more we can do from the regulatory side to provide clarity would be better. I think the alternatives, whether it's payment for the actual market making services, different tick sizes, are all up for nice debate and we can have a discussion about various questions you have on that. Thanks.

MR. NALLENGARA: We went through a lot of material there. If there's any questions. Paul?

MR. MAEDER: Both fantastic talks, very compelling. I feel a lot better, too. We've always said that there's three straws that broke the camel's back. SarbOx, Spitzer and decimalization. The third, which was really not addressed by JOBS may be the most important. Really great to see you guys picking up the flag and running and trying to address this.

Question, David, in your talk you didn't show any data on holding periods. We live in a world now of sometimes millisecond holding periods, which is obviously not investing, it's speculating. You did tangentially refer to it in your list of winners and losers.

But my question for you is, do you have any data on average holding periods? There is obviously-- it would be meaningless to hold a stock for half a second with larger tick sizes. So it would discourage that kind of activity which it really isn't, I don't -- in my personal view, productive at all for capital formation.

MR. WEILD: We've got a chapter on capital formation in this book that was just published by-- and the foreword is written by Senator Ted Kaufman. But it's very focused on high frequency. It's called "Broken Markets" and how high frequency trading and predatory practices on Wall Street are destroying investor confidence in your portfolio. I think we circulated the paper that we did that was the preamble or the precursor to this on tolls, and having adequate tolls.

The answer to your question, the numbers that I know, Paul, are that the average holding period by frequency traders is 22 seconds. They represent anywhere from 60 to 70 percent of the volume in the markets. The problem is, that we believe from talking to regulators and people that are actually going in and doing audits that there's not a lot of high frequency activity in the micro-caps and the small-caps, if you will, and the nano-caps.

In some respects, you could probably avoid a lot of the kind of the political hullabaloo by just changing tick sizes for small-cap and smaller, and probably-- in fact, I would argue over the long-term it would improve their businesses because it would create a feeding system. I think that most of that activity is going on in the S&P 500, and one of the one of the great frustrations I've always had when I look at all the letters that are written to the SEC on the equity markets concept release, is that there is just this nasty habit of confusing volume and liquidity.

Then there's also the question of whose liquidity, right? What's happened is institutional liquidity, particularly micro-caps, has been sort of decimated, so people have moved up markets. I took companies, I took 500 companies public. I used to do $10 million IPOs in the early '90s and the late '80s. We didn't have a problem finding institutional buyers.

One of the things about our sample set that shows declining IPO performance over time is that actually, within the sample set, the companies are much more mature. That there is this kind of schism that's going on where you have what we like to call demand pull big brand stocks that seem to sell themselves, so everybody wants to own Facebook or Zynga. Then there's everybody else, like the biotech companies that somebody needs to get on the phone and market.

One of your industry colleagues, Jim Blair from Domain, who won a lifetime achievement award from the National Venture Capital Association said to me that we fund the program now in biotech as opposed to funding to the benchmark. The reason is that that when you had a success and you made it through phase two clinicals, people would get long and loud and get on the phone and they would mark the value of the stock up. The market doesn't work that way anymore and the reason it doesn't work is because nobody can get paid to tell stories.

So that's the practitioner's view. I hear-- the bubble collapse clearly did damage to the psyche of the market. But when you look at the massive amount of money that was raised by the venture capital industry at the height of the bubble, ‘98, '99, 2000, it was unprecedented. Then we did have a bull market in 2004, '05, '06, and we did see 200 IPOs a year getting done.

But literally, we should have seen five, six, seven hundred getting done in that period, and that's the market structure change, in my view. That's taking the big out of it as we like to say in the business. Taking the incentive to market and support things and reach more investors. You've got to tell stories, you've got to reach critical mass numbers of investors, not just on the offering but in the aftermarket because somebody's going to spit out.

I had Jeff Vinik, who was running the Magellan Fund, one time. He just came in on a deal that we did and had two million shares that they'd bought, swore they wanted to own and didn't like the numbers in Europe. Said two million shares, back in your face, literally what he said.

But we had the economics at the time to get people on the phone and make calls and try and replace that. We had a middle market institutional sales desk. No firm on the Street has one today. We had a machine that effectively could remarket securities. That remarketing machine-- this was a baked-- First Brands, a baking company if my memory serves me correctly -- is gone from the market.

I think that high frequency problem, a bigger problem on large-caps, and I do think its harming investor confidence. I think it's a smaller problem in the micro-caps.

MR. DENNIS: This question is for Jeff. I was troubled by the slide with the poor three-year returns. Because if we-- no matter what we do with the market, if the companies don't perform and the market doesn't perform, then no one's going to buy into it.

I guess my question is, has there been any research as to the why? Your chart here shows that under $500 million has not returned anything to the shareholders, right? I can see that being two pieces. One is the market performance, and maybe that's tick sizes and maybe some other things that's driving the inability of the market to price the securities and provide liquidity, and the other is the company performance.

I guess, has there been any research as, has the companies in this market set performed up to expectations of the original IPO, or have they under-performed the market, too, and that's part of what's driving this?

DR. HARRIS: I mean, this is all based on Jay Ritter's work, back in the '90s he had a paper looking at long-run performance. He does not only market adjustment but he does style adjustments as well in his papers. That's out on the web if you want to see. But those are still pretty bad numbers.

I think in that sense, the style tries to equate like a firm in the same industry, if it's a healthcare firm with another set of healthcare firms. That tries to benchmark to some of the industry effects that you might find, having the different composition of IPOs. Generally speaking, I think it tends to be the smaller firm problem. I don't know if anybody's actually nailed this down.

MR. DENNIS: I guess my follow-on then, that is there, as we study this issue, I mean, the tick size issue is something that we need to think about and address. But is there a better time in the process than for a company to do a public offering as opposed to the under $10 million sale, at least according to these statistics where your chances are you're going to lose half your money?

As we think this through, maybe it's making it less of an incentive to go public early in that process, and you need to get to-- at least according to this chart, some certain size. I'm sure there’s a lot of factors that go into this chart. But it just seems like it's a much more complicated issue than one facet of this.

DR. HARRIS: Well, that's part of why I wanted to put this in here, because it is a multi-faceted issue. I don't know if there's a prescriptive way to say there's a right time for a firm to go public. I think the market tends to try to figure that out. The fact that we find differences across these fundamental factors suggests that it's not a perfectly efficient market in that sense.

There has been some research on how IPOs are priced and the earnings that they produced in pro forma statements, and what happens afterwards. But most of that actually tends to be a little more nefarious, that firms change accounting rules going into the IPO or it's an equity issue or something, to try to fool the market that can't unwind the actual results.

I don't know if there's prescriptive-- one of the questions I had, I guess, is whether there's-- a lot of these dark pools and other things that have sprouted up, trading venues trading large blocks of stock. It's not -- just because we have decimal stock trading doesn't mean you can't necessarily have a ten cent spread or a twenty cent spread. It's just that you get undermined, perhaps, by the limit order rule or manning order handling rules. But, there's nothing to say you couldn't put a spread out there for 100 shares at a penny, and if you want 10,000 shares it's 10 cents.

That's not precluded by the current market structure. It just so happens I don't think anyone's ever come up with a feasible solution that that works in. I'm not sure why. But there are these other sort of mechanisms outside of just broker-dealer relationships, whether it's a dark pool trading or something that goes on off the exchange in the upstairs market of the New York Stock Exchange or something. Those are sort of industry reactions, I think, to what we're finding.

In David's numbers, it doesn't seem to be liquidity at the penny tick, it's 100 shares and what goes 100 shares when you want to get rid of Jeff Vinik's throwing a million shares back in your face. That's a problem. Unfortunately, I don't-- tying all these loose ends down is a problem, an issue.

MR. CHANG: If I look at your poor three-year return chart, seems like the reducing tick would reduce the losses by small investors. So in some sense, it's a positive effect, right? I mean, it discourages the promotion of stock to small investors because you can't afford to do it.

MR. DENNIS: Well, I think that might be true. Unless, I mean, I could see this being two factors. One is company performance and if that's the case whatever we do, the market isn't going to change. But if there's a liquidity issue, then I can see, you price the IPO and then you don't have liquidity afterwards because of the tick sizes is going to drive down the price of the stock, regardless of the company performance. I just see there's probably two factors here; one market driven and one company driven. There's two solutions.

DR. HARRIS: There is a little bit of evidence. As far as market structure goes, some studies have done switchers, where firms-- basically their sort of mode of research 20 years ago used to be those that moved from NASDAQ to New York Stock Exchange because you got smaller ticks in New York, you reduced your cost of capital. A large number of firms would transfer to New York before they did a seasoned equity issue because you got smaller spreads.

NASDAQ was vilified for these 25 percent spreads, they got sued over this in the mid-'90s. The odd part about that that nobody's quite figured out, I don't think, is that there's been a set of firms now that have moved from New York to NASDAQ, also usually received with positive news that there's a uptick in their stock price, that suggests maybe there is some preferred habitat of this ratio of stock price tick to their stock price.

Jim Angel's research would suggest, and his paper actually did suggest, that with the reduced tick size, the economics of this would make all stock prices on average lower. Because if I can make 10 cents-- or if I can make 25 cents a spread on a $25 stock, the same as $10 on a 10 cent spread, or $1 on a penny spread. He actually had it in his paper that he predicted that the average share price would fall based on tick size, to try to accommodate this economy.

MR. WEILD: People would split--

DR. HARRIS: Right.

MR. WEILD: -- their shares. So it wasn't that you would have a degradation in value, it's that somebody had $20 would split it to 10. So two shares for the same aggregate price.

DR. HARRIS: There might be something there, though, in the IPO market, where if the average IPO is $10 a share, under 25 cents ticks, maybe the average IPO should be $2.50 now. But then we run into sort of the problems with penny stock rules and other regulatory constraints. That when we get down to too small, the economics go away.

I think that's one area where I didn't mention too much, but I think where some of the theory suggests that-- it lines up with David's hypothesis. There should be some sort of economics to making markets in these small-cap firms or small IPOs.

MR. WEILD: I can't remember which academic it was, but there was definitely a-- I know they saw the effect that there was more brokerage or more retail accounts that purchased the stock. They attributed that, I think, in the literature to probably the fact that the reverse splits that had occurred, and that the economics per share because the tick size per share, per dollar increment, was higher, that it was a greater incentive for people to get on the phone and actually distribute this security, which is what we've been saying.

MR. CHACE: Sir, if the business model of trading small in micro-cap stocks is kind of broken, and you're seeing firms exit, why aren't you seeing-- you're sort of proposing a change in the tick size to compensate. But why aren't you seeing price increases or commission increases from brokers?

Has any of that happened? Because I think we have-- I manage a micro-cap mutual fund, we're mostly a small-cap firm. There's an execution only price which is typically a penny, and then there's a kind of research services price, which can be two to four, typically. But why aren't you seeing brokers basically say, hey, we won't do that for a penny, we'll do it for two because we can't make any money on it? That's kind of what a market is, I would think, right?

MR. WEILD: They don't have pricing power. On the retail side, you go back years ago, you used to as a retail broker and-- at Merrill Lynch, for example, you would earn $200, $250 for a round-lot trade. Then all of a sudden, the online brokerage firms, dropped those prices to $25. I think now you can do it at $5. No one would advise people. People very quickly reengineered their businesses to do asset management to-- so it was like whack-a-mole with actual costs for investors. They just charged people in a different manner.

In the meantime, you had nobody on the other end of the phone acting as a buffer. I think a lot of the problem with the dot-com bubble was-- and we actually have this in one of our papers-- is if you look at the number of online brokerage accounts that were opened up, they're very much in pow-wow with the bubble itself. They had money that was just getting-- that was flowing into the market. Nobody on the other end of the phone to tell you it's not a great idea to bet everything on Pets.com.

So again, it was the big popularized stocks that were succeeding in everything, which are the capital intensive industries, the biotech. If you look at that period, it was the biotechnology companies, the semiconductor capital equipment companies that were kind of left behind. If you look at the dot-com bubble, it was a very narrow bubble. It's not that we were not doing too many more IPOs. What we were doing is, if you actually saw that same chart, you'd see that you were raising three times as much money on average IPO for earlier stage companies.

To your point on the institutional front, I mean, I talked to guys that were running institutional equity sales desks, and they were under relentless pressure from the institutions to cut their costs, cut their costs, cut their costs.

I don't think anybody's got any pricing power. I mean, you can talk about putting it back all you want, and trying to increase prices. But it's a very difficult thing to do. The CEOs that are running these businesses that I've spoken to are projecting that there's going to continue to be erosion in the revenue model on a per-transaction, per-share basis.

MS. JACOBS: I'd like to ask, when you talk about the advent of decimalization, there was also a confluence of other things happening. When did the Spitzer issue hit, and when did SOX? Wasn't SOX about 2002? Because it was like everything just-- we switched from NASDAQ to the NYSE in 1998, bingo, right at what your slide was talking about.

Now we never talked about the split. We never talked about that. We went to the NYSE for transparency. We were attracted by the idea that we would have a specialist who, back then, would help us make market. Worked for a little bit of time. But we didn't know there was a Titanic event sitting out there, which I think is a confluence of the three things that Paul was talking about.

When did the Spitzer thing happen? Am I correct that SOX was 2002?

MR. WEILD: Yes, SOX was in 2002.

MS. JACOBS: Right. I want the relief from the decimalization, but it won't be enough, is my fear.

MR. WEILD: It's a great question. I mean, when you look at the sort of the cataclysmic drop-off, when you look at that mountain chart, something happened. If you look at what was going on, it was order handling rules, and then all of a sudden at Reg ATS, which I think gave life to the order handling rules, by giving people an electronic mechanism to degrade spreads.

I don't think it's coincidence that we blew up the small IPO market and it never recovered. That one chart there, I think if you don't-- if you don’t look at anything else, that one just really is disturbing to me, it never recovered.

So to your point, I think you can get rid of Sarbanes-Oxley tomorrow and I don't think you'd bring back the small IPO market in this country. I think that the costs and the disclosure stuff, that stuff's important for markets. I think that making costs reasonable and figuring out a way to get them down for small companies is critical. There's an optimization exercise.

But if you just repeal Sarbanes-Oxley tomorrow, because I know it attracts all the hubris, and part of what was motivated in the JOBS Act was this sort of anti-Sarbanes-Oxley movement. I said, that's not going to fix your IPO market. It's not going to fix your aftermarket support market.

The research thing, and I want to write a little bit of a paper on this historically. But about equity research and I have a cousin who was the chief technology officer of a company called StarMine that was sold to Reuters. What StarMine did was it created products for the institutional marketplace to look at what had predictive value in equity research analysts' work.

What he told me was that there is no predictive value, even today, post the Global Settlement in analysts' recommendations. The reason for that, I believe, is that there's bigger conflicts that separation between banking and research haven't addressed, which is that if I'm Fidelity and I've got-- or any of the other major institutional investors, and you put a sell recommendation on the stock that I'm long, your analyst is going to call and raise hell with you and threaten to cut your commissions.

That if you are looking to get Steve Ballmer, and I'm just using names here very loosely, I'm not picking on anybody and it's not specific knowledge. But I hear this from the trading desks, that Steve Ballmer and Microsoft is not going to want to show up at your annual technology conference or do a non-deal road show with you if you've got a hold recommendation on the stock.

These things have real impact on the economics of the business. As a consequence, the ratings still don't correlate to-- don't have any predictive power. I'm not sure that we shouldn't just take the gloves off a little bit and let people transact and stop calling it equity research as if it's some ivory tower pursuit, because it has a commercial value, and call it information sales or something to that effect, because-- which it is.

But we've done a disservice because people still think that this stuff has predictive value and in point of fact, there's no evidence, from what I understand, that it does.

MR. BORER: I've got a point I'd like to make, just as a practitioner, because I think I'm the only person on the panel that's actually in an investment bank and broker-dealer.

There was one of the papers I read in preparation for this meeting was using the terms "perfect storm," which involved a whole host of things that came together to create this confluence, which was quite destructive of market structure, the number of firms offering services, and all those types of things.

This discussion reminds me of the movie, the end of the movie. I don't know if anybody remembers this, but the giant swell with Mark Hamill floating away, he's the good guy, and this-- what Christine was just saying, well, what do you do at the point where you're floating away in the wave? He's still alive, still breathing, everybody else is gone.

Changing something like that storm, it can't be done. Until-- and I don't know if it's the decimalization, SarbOx or any of these other things, but until we start to see the formation of new firms coming in to provide these services, and the appropriate market structure will incentivize them to do that, then I think that just changing the decimalization might make it better for those who are still in the glue factory waiting in the line to get slaughtered. But otherwise, I don't think these things incrementally will have that big of a difference, irrespective of JOBS Act and those types of provisions.

I say that as a practitioner who at the end of my career, hopefully, in doing this I see the young people coming in. They're not going to be the spin-offs from the bigger banks to do this and take the regulatory burden, the market risk, the capital employment that needs to take place and the market structure problems, which are too large of an impediment to be able to bring the smaller companies public through conventional means, or even through alternative means.

MR. MAEDER: It doesn't mean we shouldn't try. It may not work--

MR. BORER: I agree, Paul. I agree, and that's why we're here. But it's just a-- some opinion, editorial on it.

MR. MAEDER: Yeah.

MR. BERMAN: Just to reflect that, I actually do agree with the general comment that we should try. But I want to come back to something, David, that you said at the beginning, quite colorful language about flesh-eating bacteria. The first thing that came to my mind was the show "House." I don't know if anybody watches "House." You probably all watch it but no one wants to admit that they actually watch it.

[Laughter.]

MR. BERMAN: I'm fairly certain if I looked at your TiVos, you'd have the season. So yes, it's just finished.

"House" starts at 9:00 o'clock. At 9:20 they're absolutely certain about what the cause of the problem is, and they can have the symptom. Then House walks in and says, “but, you realize that if we're wrong, we actually kill the patient?” There's actually a bit of a danger if you treat the symptom but you don't treat the underlying cause.

So far I've heard a lot of comments here about, it might be different things, and we might take steps down that path. But I've also heard some comments on, it must be this case, and it would be difficult to be in a situation where we say, you know what, the whole problem was tick size. That's it. And we go out and we focus on that. We find out that actually, while that might have been a contributing factor to create the perfect storm, the-- you don't-- to not get into the perfect storm, you don't go in the water at that time. But you can't pull the wave back.

The thing that made you get there is not necessarily-- unwinding that is not generally the solution. You actually might have to have a different solution to actually get to the same outcome that you want. That usually happens about 9:40, and then about 9:50 House throws the ball against the wall and then he finally he thinks of something because someone rings something. And he's, oh, now I understand the answer. It usually turns out that it's a combination. It's something new that he has learned that was not related to what the original diagnosis was, but yet you had to get the original diagnosis at the same time.

I'd be a little nervous about sort of hanging our entire hat on creating a brand-new market for IPOs by saying, if we only changed decimalization. There are a few charts that folks showed. I think Jeff, you had a chart that showed spreads on NASDAQ decreasing over time. But that was a volume weighted chart. I mean, it sort of goes without saying, the change in decimalization did not say that spreads were a penny. It said spreads were allowed to be a penny.

I don't have a lot of experience taking companies public, I only took one company public, my own, so I have a good sense of exactly what it means to go public. We never thought about spreads. That was totally irrelevant. I was just thinking about clients and products and services at the time.

Whatever the spread was, if it was a penny or ten cents, we don't have control of that, completely irrelevant to us when we went public. When decimalization happened, who was in control of that? Well, that would have been the market makers who were providing that. The regulation allowed those who were providing liquidity, and making money on that provision of liquidity, to determine their own spreads. For whatever reason, there were market forces, I think someone mentioned this, that drove those spreads down. Regulation didn't drive the spreads down, it was those who then said, wow, now spreads are-- if you're right, then those same people saying, wow, I guess I shouldn't have driven the spread down that far.

Now if you looked today at illiquid companies and small-cap companies, spreads aren't a penny. Spreads are five cents, ten cents. In fact, there are quite a number of companies where the spreads are so wide that we had to think about what the effect would be on our limit-up, limit-down rule. If you read through that rule, you can see that we actually have discussed that a bit. There are many companies that are illiquid with large spreads. We've got a lot of feedback that, if you could only force those spreads to go down, you actually might make the company more liquid. It's not a binary decision, it's a perfect storm. But the answer might actually be very, very complicated.

MR. WEILD: Those are not monetizable spreads. You can step in front of a guy for a penny. Why are you going to get long and loud for 100,000 shares when the thing's trading with a quarter point spread if somebody can go in at ten and step in front of you at 10.01 or something like that. That's why they're not-- and in fact, you're dead-on right.

There's a lot of evidence-- I think I saw one of the letters on the equity concept release that Russell 2000 spreads had not materially declined since, I think, 2003. I think it was Knight Securities data. Those are billion dollar kinds of companies. But the fact is that nobody can actually reach out and turn that spread into a return, so they don't get on the phone. If they could make capital to get their lungs ripped out, euphemistically. That’s the issue. It's what you can rely on.

MR. BERMAN: I think you make a very good point, is that decimalization had two effects. It's not just the spread change, but it's also the ability for someone to say, look, I have a 15 cent spread. That's what I'm willing to offer the market at. Someone else to come in and say, well, I'll do it for 14 cents.

Now again, it's a competitor, it's the market determining that. But that's an effective-- I mean, I think we just called that pennying here. That doesn't mean the spread goes to a penny, it just means that you stepped in front. But the solution to that might be a little more complicated than just changing the spreads or allowing the issuers to change the spreads.

MR. WEILD: No, I totally agree with that. That's why I mentioned about dark pools and the notion of people stepping in the middle of the tick size, for instance. You have to kind of create some standards there so there's predictability so that somebody will actually step up to the plate and take the risk. If there's no predictability in it, then they won't.

MR. MAEDER: Are you saying, Gregg, that smaller spreads have benefited investors because they're paying-- smaller tick sizes have benefited investors because they're paying lower commissions? Because absolutely, it has. But the function of the SEC is not to just benefit investors. It's to create a productive and orderly market. If it's benefiting online investors to the detriment of issuers and companies that need to raise capital and create jobs, then it isn't fulfilling its mission.

MR. BERMAN: Well, I think I could not agree more. Which is that we do have a broader mandate. What I was reflecting is that just if you look at a lot of the comment letters that we've received from the equity concept release, and just general academic research, there are pros and cons of both of those sides.

As we think about, through any types of solutions, we want to say categorically, if you do this, this has only positive effects, therefore it's sort of a no-brainer, that there's always unintended consequences. It might be that, on the balance on way versus the other way, works, but at least you have to think about all those different things.

MR. MAEDER: The nice thing about “House” is that, by letting his silly staff go after the wrong diagnoses, he does eliminate a lot of incorrect diagnoses.

MR. YADLEY: Jeff, you had three-year data here and we've talked about prices 30 days out, a year out. Is data different at four years or with smaller companies, exits within three years, positive, negatives, sale to a larger company, going out of business, going private?

DR. HARRIS: Most of the research from Ritter's work actually tries to accommodate for the survival by us or people that-- companies that get bought out before those three years. He has done some longer-term things that look similar.

It is generally, it is sort of a longer-term phenomenon, whether it's three, five or seven years. Then he tries to actually accommodate the fact that some firms get bought out and there's a differential, he counts that return within that.

MR. YADLEY: Is it generally more positive, less positive? I mean, I'm just wondering-- and you could look at the last ten years of prices, generally you're right, it's been pretty flat. But companies that were priced right, had some growth, got bought, particularly bought up by another public company in a public deal where there was a premium paid, I'm just wondering, is the picture brighter for some companies? Of course, everybody's not going to make money. Every deal's not going to let that happen.

DR. HARRIS: Generally speaking, you're right, the firms that get bought out do better. There is this sort of private market of merger and acquisition segment that does better because, of course, a lot of firms that go bankrupt and have the negative 100 percent or something, by definition, are included in those averages that aren't included in that other set.

One of the issues with market structure of that is, it goes back to some of the demand, I think, on these IPO prices. If we were to try to establish a 25 cent market spread, I think we would have a little-- I wouldn't see investors lined up to say I want to pay a 25 cent spread. I don't see investors out there. We have spreads now in the small-cap market that are quoted out there. It might be stepping ahead, but you could still-- there's still mechanisms, I think, from the mid-cap and larger-cap stocks, the dark pools have emerged for that reason. You don't want to put up 10,000, 20,000 shares in your book so you send it through a dark pool, see if you can match with a counterparty on the other side before you send it to the market.

But I don't see much of that happening. I'm not sure we have much transparency in dark pools. That's, I know, some academics are on the cusp of trying to get some of that information to find out, are there some of these alternative mechanisms for outside the exchange where we won't get pennied or stepped ahead of, where we can do a transaction outside of the organized exchange?

I know, knowing my friends since I spent a lot of time at NASDAQ, they're a little disturbed by the fact that there's a lot of dark pool trading, because that's off exchange and they don't get remuneration for that, either. But those, I think, are some interesting studies that could be done, maybe. I don't know. You guys have the data.

MR. GRAHAM: Okay. This has all been fascinating, and Jeffrey and David, I think that you've been great, and I want to thank you for that.

MR. WEILD: Steve, I want to make one comment.

MR. GRAHAM: You can make one comment. But I just wanted to cut it off, because I think that there's a lot of good information and we appreciate the fact that you're here as resources. So I just wanted to just note that we're kind of encroaching on the lunch period, and give people kind of a two-minute warning, if you will. Let's have your comment and then let's see if we have one or two more questions from the Committee.

MR. WEILD: This is following up on something that Paul and Gregg said. You can save money for investors on transaction costs, but it doesn't mean-- the paradox of it may be that you've actually shifted down economic activity.

Economic activity is actually correlated long-term to investor returns. Even though, in terms of short-term, it's not clear that you've actually saved investors in the aggregate any money. You might have actually harmed them by depressing the economy.

This part about survivor bias, where actually you acquire successful firms, it was very interesting to me because the SEC made us change our accounting when I was at NASDAQ under SAB 101, and calculate the useful life of a listed company-- or the average life. On NASDAQ at the time, it was only six years. On the New York Stock Exchange, it was something like eight or eight and a half.

I think they both moved out, because we've got fewer IPOs. But suffice it to say that these are really, if you will, bridges to somewhere else. A lot of the economic growth that we're kind of, I think, leaving on the table is the fact that we don't have a functioning IPO market that serves as that bridge.

MS. JACOBS: Can I ask a question? Take it back up to 30,000 square feet for those of us that are currently in that suffering bubble. Is the chance for your suggestions, has it got any traction? Has it got legs? I mean, there are so many issues and we have so many in-depth discussions in and around the plight of the existing small public companies. I'm starting to wonder if we aren't better off with our own exchange.

But your suggestion is valid. It's attractive. There's a part of me, as a CEO, that's going to say, I don't want to split hairs anymore. I just need some relief.

MR. WEILD: We actually, even though we didn't highlight it here, but we have an op-ed that we did in the Wall Street Journal, and I wrote in the Wall Street Journal, I think it was in November or so this past year, calling for a totally separate stock exchange focused on sub-$2 billion market value companies where you'd actually set management teams, institutional investors and member firms at the table a little bit like back to the future, if you will. But to try and focus on making markets actually work for small-cap companies again, and that's another alternative.

The choose your own tick size got a lot of traction because people said, look, you don't have to abrogate Reg NMS, and it's just bits and bytes and it should be very cost effective to do. For me, it doesn't matter what fork you take. You may want to take both forks and give them both a try. I think we've got so much at stake as a nation here, in terms of getting it right, that issuers deserve to have options, real options.

Under what I like to say right now, when people ask me about the difference between listing on the New York and NASDAQ is that there's a lot of services associated with it. But because of Reg NMS and Reg ATS, I mean, all these stocks are trading essentially the same. It doesn't matter which market you're on. We've got one choice and one size does not fit all companies.

DR. HARRIS: The only thing I'd mention is that I think having a separate stock exchange or something with different rules doesn't account-- if we believe that there's some sort of cross-subsidization going on, that I think a standalone thing would be hard to manage. That's why I think I mentioned at the end having a sponsored market maker or something where the firms could actually pay for a liquidity provider as another option that should maybe be on the table. Because it's specific to that particular instance without changing any major rules. Just -- we could even do a pilot study, individual firms that volunteer to do that.

MR. GRAHAM: The standalone market idea still might be a good one. It certainly is in the short term, but I think there is this void between public markets and private placements that I think could be filled.

One more question?

(No response.)

MR. GRAHAM: Hearing none, again, David, Jeffrey, thank you very much, and don't be surprised if we call upon you again.

Let's break for lunch and reconvene at 2:00.

(A lunch break was taken.)

Afternoon Session

MR. GRAHAM: Why don't we get started? Thank you all for coming back. I don't think we lost too many over the noon hour.

MR. GRAHAM: Our next session is going to deal with scaled disclosure. The first thing I want to do is acknowledge and welcome Chairman Schapiro and also Meredith Cross. Without any further ado, I would just like to turn the mike over to Mary to say a few words.

CHAIRMAN SCHAPIRO: Thanks very much, Steve. I actually have prepared remarks. I think I'll just ditch those in the interest of time because I know we have a lot to talk about this afternoon.

I mostly wanted to welcome everybody back to the SEC and apologize for not being here this morning. We had a long-standing, long planned meeting all morning with the regulators from the United Kingdom, the Financial Services Authority, to talk about our many cross border issues, especially those not arising out of the JOBS Act, but arising out of Dodd-Frank.

I couldn't be with you this morning, but I did hear a little bit already from Lona and Gerry that it was a terrific morning. I will get the full details from them. I'm looking forward to this afternoon's discussion about scaled disclosure. I think that will be extraordinarily useful to us as we go forward.

I just want to thank you all again for the time you're giving us and your expertise, pragmatism in helping us confront really important issues, and doing it in the best way we possibly can. Thank you.

MR. GRAHAM: Thank you. Meredith, do you want to introduce the subject of the panel?

MS. CROSS: First of all, thank you very much for coming, as Mary said, we can't say how much we appreciate the time you're giving to the Committee. It's been extremely helpful.

Obviously, all changed a bit with the JOBS Act, as you have been talking about. We continue to need to focus on a part of one of the reasons why we thought it was important to re-form this Committee, or to form this Committee. The concerns that our current system doesn't address the needs of smaller companies that don't satisfy the test for a smaller reporting company, or even if they do, that the scaling that happens for smaller reporting companies may not adequately address their needs, leads us to reconsider the burdens imposed by our rules for these companies.

They are not usually in the group of companies that we focus on. We focus on really small companies and then we focus on things like shelf registration and ease of access to the capital markets for the larger companies. There is this group of companies in the middle, sort of the great unwashed masses of companies that may need some help.

That is what this third panel is about. The JOBS Act has made significant changes to the securities laws, designed to facilitate capital formation. It focuses on the defined group of companies, emerging growth companies. Some of those are actually not very small, but they have to be relatively newly public companies going into the capital markets for the first time, and from then on, they get some regulatory relief.

Already public companies can't take advantage of any of the scaled disclosure provisions of the JOBS Act. Many smaller reporting companies have asserted that the current scaled disclosure requirements for our smaller reporting companies don't adequately address their needs, either because they don't target the right sized companies or because even if they are in the group, they don't provide enough regulatory relief. That is the topic of our sessions this afternoon, scaled disclosure for already public companies, depending on size.

To help us frame the issue, we are very lucky to have two speakers with us that provide a different perspective on the issue. Their complete biographies are in your materials. By way of brief introduction, we have Dr. James J. Angel. He's an Associate Professor in the McDonough School of Business at Georgetown University. Professor Angel specializes in the structure and regulation of financial markets around the world. His current research focuses on short selling and regulations.

Professor Angel teaches undergraduate, MBA, and executive courses focused on financial markets, world equity markets, and regulation of financial markets. Professor Angel has served as a visiting academic fellow and resident at the NASD, now FINRA, and also as a visiting economist at the Shanghai Stock Exchange. He also has been Chairman of the NASDAQ Economic Advisory Board and a member of the OTC Bulletin Board Advisory Committee. He currently serves on the Boards of Directors of the Direct Edge Stock Exchanges.

We have Paul Dorfman. He's a Managing Director in the New York Stock Exchange, Euronext, Global Corporate Client Group. His responsibilities include development and maintenance of relationships with companies listed, and considering listing on NYSE Euronext and NYSE Market platforms. NYSE Market is generally focused on listing and trading smaller public companies.

Prior to joining the New York Stock Exchange, Paul was a financial analyst with Morgans Waterfall Vintiadis, a distressed debt investment firm, an assistant controller with Odyssey Partners, an investment firm, and accountant with Marks Schron & Co.

Professor Angel, we will start with you.

DR. ANGEL: Thank you. It's quite an honor to be here. I'm going to talk about basically better ways of doing disclosure, but I'm going to throw in some of my other comments and ideas as well on other topics.

I'm going to start by documenting our shrinking capital markets. We have approximately half as many domestic companies as we had 15 years ago listed on our markets. I know you had a market structure discussion earlier this morning. I will throw in a few of my comments on that before getting to the meat of the topic, which is how to scale compliance costs.

My basic idea is not a new one. When we are looking at costs, we need to look at costs relative to the size of the company. That is what directly feeds into the cost of capital.

We should also be quantifying how big are fraud losses in the micro-cap sector, and think about are there more cost effective ways of fighting fraud other than the ways we are going about it now.

I'm going to talk a little bit about internal controls. As we think about scaling them, let's think about not only scaling the size they apply to, but scaling the controls themselves.

Most public companies seem to feel that the COSO criteria are the only way to go. Why don't we have multiple criteria? Then when we get into other areas, like conflict minerals, most companies are not buying conflict minerals from the Democratic Republic of the Congo, so I think most companies should be able to get away with a simple de minimis warning, kind of like the Proposition 65 labels you see in stores in California, where they tell you they might have some toxic materials there.

As far as crowdfunding, I would advise that we keep the rules simple and keep disclosure simple, more like cigarette warning labels than 300 pound prospectuses.

Finally, I would like to urge the Commission to wield Section 36 like an axe. Section 36 of the Exchange Act gives the Commission broad exemptive power, and Congress gave that authority to the Commission for a very good reason.

Many of you may have heard of the Wilshire 5000 Index. It's an index that basically tries to have every domestic U.S. Exchange listed company in it. One of my favorite trivia questions is how many stocks are in the Wilshire 5000 Index. There used to be over 8,000 at one point, but as of the end of last month, it was 3,639. We have lost almost half of the number of public companies. Why?

There are multiple causes for this crisis in capital formation. I firmly believe it is a crisis. The Commission can't fix everything. Causes are everything from the litigation environment, as one CEO told me, he said hey, if you go public, you get sued.

We also have the burdens that we place on public companies like Sarbanes-Oxley internal controls that place a disproportionate burden on smaller companies.

I'm sure you heard a lot this morning about market structure. The point I'd like to reiterate is we used to have a very different market structure for small-cap companies. The old NASDAQ was very different from the old NYSE. We no longer have those differences. I believe we have gone to this one size fits all market, and I think we need to get away from an one market fits all mentality.

There are less important reasons. Some people say it was just the dot-com bubble, those companies never should have been public. Well, maybe. There were less than 500 dot-com's that came public during that era. We have lost thousands of public companies. Some people would say it's just general economic conditions, the markets stink. Guess what? We had a fairly good recovery in the mid-zeros and we are still losing companies. Mergers? A few. That doesn't explain it all.

I believe that nobody really knows the right answer. I don't have a silver bullet for it. I think we need to innovate. We need to get away from this one market fits all mentality and give the exchanges the ability to try a bunch of different things. I don't know all the answers. I believe that smaller companies will benefit from a different market structure than larger ones. In particular, they need a market structure that is nurturing to smaller companies, that gives the industry incentives to bring them public, to trade them, to create the information that makes investors comfortable investing in those companies.

There have been a lot of things talked about. I know the JOBS Act requires a study of tick sizes. Guess what? Why don't we let the issuers pick their own tick size? The industry can handle it.

The issuers themselves are probably in the best position to figure out what's the right tradeoff between the benefits of a smaller tick and a smaller minimum bid-ask spread, and the benefits of a wider tick and the incentives it provides for liquidity providers. Let them pick it.

Also, we should be open to other ways of doing things. European markets permit the issuers themselves to actually compensate market makers who promise to provide liquidity all day long. FINRA rules currently prohibit that. Why don't we allow our exchanges and our issuers to do what the Europeans appear to be able to do without causing manipulation or fraud?

Furthermore, in the mutual funds space, we have 12b-1 fees that are used to pay for marketing expenses. How about in the equity space, we could have the issuers specify a fee to be collected perhaps, a penny a share on trading, the exchanges could collect it, just like they do the SEC fee, and that money could be used to pay for things like independent research or incentives for liquidity providers.

We have little to lose and everything to gain. As I said, I don't have a magic bullet, but we need to be open to lots of innovation and experimentation.

Onto the heart of the topic, the scaling question. How do we draw the line? Well, I've read lots of SEC rule filings over the years, and the cost-benefit analyses typically try to get a handle on total costs, but they rarely if ever look at the cost relative to the size of the company. I think it's sort of a common sense idea. It doesn't require any heavy duty rocket science to say all right, look at what is the cost for a small company, and what is the cost relative to the size of the company. Either market cap or total assets.

We need to think about is the increase in the cost of capital to that company worth the benefits that change is designed to achieve? Quick numerical example. Let's suppose we have a regulation that has an annual fixed cost of $1 million. If a company has a market cap of a billion, that is .1 percent or ten basis points added to their cost of capital. If their market cap is only $100 million, it's an one percent increase in the cost of capital.

Let's look at Sarbanes-Oxley 404. In 2009, the SEC did a survey, and they found the average cost for companies with a market capitalization of $75 to $100 million was $678,000. Notice that was far higher than the original estimate of $91,000 in the original rule filing. If we do a little arithmetic here, say 678, the companies are between $75 and $100 million, so we will take the average, that is, .77 percent. That is 77 basis points.

That is a huge increase in the cost of capital for a small company, when you think that typically the cost of equity capital is somewhere in the ten percent range. We should be very, very careful doing anything that is going to impose burdens more than just a few basis points on a public company.

Traditionally, the cost analyses have ignored all the indirect effects, because if you raise the cost of being a public company, guess what? We have seen it over the last 15 years. You get fewer public companies. What does that mean? Less access to the public markets. That means fewer exit opportunities for the venture investors.

If they can't monetize their investment, they won't get in in the first place. If you have fewer exit opportunities, that means fewer people bidding for those companies. If you can't sell to the public markets, you can only go to private equity or other places, fewer people bidding for your company, you get less for it.

That means less returns to investment in venture companies, less returns means less investment up front, less investment up front means fewer jobs, less economic growth.

We need to take into account not only the direct paperwork costs of everything we do, but also the indirect costs further on downstream.

This is probably a late hit on cost-benefit analysis. The Commission has a long history of treating cost-benefit analysis kind of like the appraisers in a mortgage deal during the real estate boom.

Bring in somebody after the fact to bless the deal, and indeed, have they ever dinged regulation for being too costly?

I understand the Commission is taking great steps to take the economic analysis into consideration earlier in the rulemaking process. I think this is long overdue and I really want to encourage this to become the normal way of doing things. In addition, we also need to continue to do ex-post studies of the costs to calibrate the ex-ante studies. We also need to be thinking about why are we doing this. With some of the rules, Congress says do it, but Congress also gives the Commission tremendous flexibility on how to do it. Whether it's the 3A warning that says worry about things like not only public protection of the consumer, but also efficiency, also competition, capital formation.

Every rule has a goal. In general, when we talk about disclosure, there are two big benefits. One is fraud prevention, making sure the fraudsters stay out of our markets, which is very important, and the second is better economic decisions by investors, so they have all the information they need to make a good investment decision. The thing to remember is with smaller companies, there is less money at risk and thus less benefit from very expensive requirements.

As far as fraud goes, well, in dollar terms, how much really is there at the micro-cap level? If we took every non-bank bulletin board company, U.S. bulletin board company, and considered it a total loss, we're talking roughly the order of one or two Enron's. I don't have the exact numbers. It's fairly small in the grand scheme of our $15 trillion capital markets.

Another way to think about where we draw the line, how do we scale all of these requirements, is to look at the total market cap of the sector. For example, statisticians always like to think about the 95 percent level. If you figure we've got $15 trillion in rough numbers, the size of our equity market, and we cut off the lower five percent tail, that's the part of the market that totals $750 billion. That way, we protect 95 percent of the dollars and we dramatically reduce the burden on small companies. I don't have the exact cutoff in market cap that gets us to the $750 billion, but it's in the several hundred million dollar range.

Fighting fraud is very important. Disclosure is one of the ways we do that, but we want to find the most cost effective way to fight small-cap fraud. Burdensome disclosure measures generally put most of the onus on the law abiding companies and very little on the real fraudsters. I think society's resources are better spent by doing things like criminal background checks on the officers, directors and promoters. Look at their criminal records, their credit reports. Find out if these are the kind of people you want running public companies. Look at the records of the transfer agents and see who is acquiring large blocks. That often will tell you what kind of games are being played.

Then we have Sarbanes-Oxley Section 404. In the slide in front of you, I have actually reprinted Section 404. People who were here at the Commission at the time said they didn't think it was a big deal. Indeed, when I first read Section 404, I didn't think it was a big deal either. All it says is okay, the issuer has to give you an assessment of their internal controls, and the auditors have to attest to it according to some standards issued by the Board.

I thought cool, now we will get some useful information. We will get a little report card. This company has an A, that company has a B. Maybe a little table about what's going on. The way it was implemented was it effectively turned somehow into a de facto command to meet exactly one size fits all level of controls, the so-called COSO standard from the Commission on Sponsoring Organizations of the Treadway Commission.

The law does not call for the COSO standard. The law just calls for an assessment. Tell us how good your controls are. It does not specify any particular level of controls. When we are considering how are we going to define this assessment, remember, it is only an assessment, it doesn't specify a level, I just want to reiterate the fact that the law says use common sense. Section 3A of the 1934 Act says think about efficiency, competition, capital formation and consumer protection. The regulator's job is to balance this in a common sense way.

When I think of an assessment, I think of the grades that I give my students. I think of it as the scores they get on a final exam. Most of the time, it is not pass/fail. Most of the time it is not effective/not effective. Why not permit the form that we specify the assessment to be to be a report card, A, B, C, D, or along the same lines, why not have more than one standard?

I have nothing against the COSO standard for the S&P 500 companies. Why not have explicitly different standards, some of which are geared for smaller companies. We could have the large-cap standard. We could have the mid-cap standard. We could have a small-cap standard for different classes of categories. Indeed, maybe exchanges may require a particular standard to be in a particular category in the market. I would expect the NYSE to have the highest standards for its highest tier, but permit the small-cap standard for the NYSE MKT market.

In reality, what we have is if they want to be listed on an exchange, they have got to live up to the COSO standard. If they want to trade on the bulletin board or the pinks, they don't have a standard, or if they want to be private, they don't have a standard. Indeed, we have had many firms in the last decade voluntarily going dark, plenty of foreign firms. Some of my favorites are the folks that make the Etch-A-Sketch. They went dark. Federal Screw Works, yes, there is such a company. They make auto parts.

What we are seeing is a shrinkage of our public markets because of the cost of being public. This is really depriving investors of plenty of good opportunities and it's depriving companies of the capital they need to grow.

In terms of other disclosure, things like conflict minerals. I know this is a very difficult issue for the Commission. Let's think about the intent. Congress wants to shine a spotlight on the companies that are doing business with the people who are dealing in death and destruction in the Congo, but most companies aren't.

Yet, these conflict minerals include things like gold and tin, stuff that's in every computer, every cell phone, and requiring an audit of every little bit of electronics that goes into your company. Ridiculous and useless for achieving the goal Congress wants. For the majority of firms that really aren't doing business with the Democratic Republic of the Congo, why not just allow what I call a "Proposition 65 warning label?"

The fact is they don't do business with the Congo, they don't buy stuff there, they're not dealers in conflict minerals, so let them put a little disclosure which says in the course of normal business, we buy stuff and it has trace amounts of this stuff, but we don't get any of it directly from the DRC.

Just like you can walk into any supermarket in California and you see this nice little label which says you know, some of the stuff we sell may be toxic. A similar thing would be a nice cost effective solution for dealing with the Congressional mandate for conflict minerals disclosure.

As far as the JOBS Act goes, I would really urge the Commission to listen to the message Congress is sending. Congress basically said hey, lighten up. Don't go overboard with the rules. Once again, remember Section 3A. There has to be a balance between investor protection, efficiency, competition, capital formation, and Congress basically said hey, lighten up.

As the Commission comes up with the rules for the crowdfunding, let's try to keep the required disclosures, the required paperwork as simple as possible. Notice the JOBS Act creates plenty of liability for serious omissions. If some scam artist doesn't disclose what's going on, they already have explicit liability. In designing the rules, why don't you target a maximum length for the disclosures?

Furthermore, think about the warnings. A cigarette warning label is a lot easier to comprehend than a 500 page prospectus. Dodd-Frank gave the Commission authority to do a lot of consumer testing. Why not use it?

Here's an example of what I think makes sense for the smaller issues to crowdfunding. Put in a big label, not too many big words, big print, not all caps, because that is hard to read, and just say hey, look, this is risky. The information here is not the same as you're going to get for Exxon. By the way, you may not be able to sell this if you want to sell, and this is so risky, you may lose it all. Simple, clear, to the point.

You have a nice big warning label as opposed to our normal thinking about disclosure, which is you come up with a 200 page book filled with repetitive fine print boilerplate that most people can't understand, keep it nice and simple. It will do a better job of protecting investors, warning them what they need to do, and it will reduce costs all around. It will reduce costs for the issuers. It will reduce costs for the Commission.

I'd like to say that even the crowdfunding rules need to be scaled. Congress went, and in their infinite wisdom, they permitted far bigger offerings than many of the crowdfunding advocates wanted, and they gave the SEC a lot more rulemaking authority than the crowdfunding advocates really wanted.

The Commission should use common sense to use its Section 36 exemptive authority to permit very simple disclosures for the very smallest offerings. For example, only $1,000 per investor, $100,000 total. Simple one page on-line registration form with the SEC so you can keep track of who is doing these things, and if their criminal background checks disclose those are the bad guys, you go after them. Have micro-cap page warning to investors, basically indicating hey, this is a lottery ticket, you will probably lose, but even still, these should be scaled as well.

I really would like to remind everybody here that Congress put Section 36 into the Exchange Act for a very solid reason. They understood that sometimes you have to make exceptions and especially for smaller companies. I've always been mystified by why the Commission hasn't made broader use of this particular power, that conditionally or unconditionally exempt any person, security or transaction from any provision of the Title or the rules or regulations, as long as it is necessary or appropriate in the public interest and consistent with the protection of investors.

When you think about the tradeoffs the Commission is asked to make between consumer protection, efficiency, capital formation, Congress is basically saying hey, use common sense. When I hear people say oh, our hands are tied, Congress told us to do this. Yes, they told you to do it but they didn't tell you to do it badly.

To summarize, we don't know all the answers for fixing the problems in our small-cap sector, so we really need to be open to experimentation and innovation. When the exchanges want to try something new, let them try something new. Let the issuers pick their tick size. Let them compensate the market makers. Let them experiment with different things. If it works, great. If problems show up, well, then the SEC has very broad authority to clamp down later.

When we think about costs, every cost-benefit analysis should basically look at different sizes of firms and look at the cost relative to the firm size. When we look at Sarbanes-Oxley, we really should have multiple different standards, and let the issuers pick the appropriate standards.

If investors know this company is only applying small-cap standards, that is important information. Let investors make the decision as to what is the appropriate decision along with the issuers.

As far as conflict minerals go, a Prop 65 warning label is probably good enough for most companies.

Finally, for all of the JOBS Act and crowdfunding, I really want to urge the Commission to think about cigarette labels and not 500 page prospectuses.

I want to thank you all very, very much. Do we do questions now or after the next speaker?

MR. GRAHAM: Let's do them after Paul.

DR. ANGEL: Okay, great.

MR. GRAHAM: Let's put it all on the table. Thank you, Jim. I think that helps us to kind of understand the issues a little bit better and kind of gives us some ideas of how they might be resolved. Appreciate that. Maybe Paul is going to give us some real life examples.

MR. DORFMAN: Thanks so much, appreciate the opportunity. Really my comments are mostly limited to reiterating or summarizing what some of the listed companies have said in outreach we have made to them, eliciting some feedback from them with respect to this Committee.

Quickly about those companies, under $250 million market value public float, there are about 1,933 of these companies, a good sized community. In terms of the economic engine or let's call it the jobs that they account for, there are about two million jobs associated with these 1,933 companies. These are companies just on NYSE, NYSE MKT and the NASDAQ.

By comparison, I looked at some other companies with a similar market cap or market value, public float, if you will, of about $150 billion, which is the total of all of these 1,933 companies.

HSBC is right around that size in terms of market cap. They have 288,000 employees. Also in that market cap is Google, newer company, and they have about 35,000 employees.

The number of people impacted by what we are doing here is two million people, an extraordinary number of people, extraordinary amount of an economic engine. Maybe it's not as efficient as having them all wrapped up at one company, but I think in terms of jobs, not the JOBS Act, but in terms of real jobs, it's critical that this community of companies find some relief, have their voices heard, and allow them to thrive in this day and age. It's quite a great group of companies and of course, a diverse group of companies as well.

Just very briefly, these are some of the areas that the companies or executives of these companies have commented on. Got about 20 some odd comments to our outreach. We reached out to these smaller companies on the NYSE MKT. It was great to hear what they had to say directly.

The first couple of slides are on disclosure. I'm not going to read them. As you see, they're in quotes. Our attorneys made me do that. By the way, this is their speaking. This is not the NYSE Euronext speaking at all, as I'm sure you know. There is the note right there at the bottom.

The first three here are basic comments that we have all seen before. The second point here is just commenting on there is just too much detail required in a lot of their filings. The third comment discusses the boards and looking for boards of companies, which is to get back to what their job already is, instead of having so-called "experts." Again, these are their words, do some of the work boards should be charged to do.

Of course, as you might imagine, we talk about XBRL is a little bit of a burden for companies. Again, smaller companies are talking here. Some of these financial statements are pretty simple, pretty straightforward. A lot of the executives feel that there is no need for the tagging, of course. The second point here is listed companies saying they want to continue, that XBRL need not be audited or MD&A need be tagged. They're saying don't do anything on those, continue with the way that is.

The next slide is on XBRL. There is one comment, a good job generator. This firm had to hire another staff person in the finance area to help work with regard to XBRL. There is somebody being hired there, helpful towards the job market.

The second comment there is allowing some time for XBRL to be done after the filings are done, because with this increased burden, they are having a more difficult time meeting those deadlines.

The third comment is a suggestion, which is always nice to get a suggestion every now and then. These cost-benefit analyses for those larger filers that are already doing the tagging and trying to find some metric to determine if there's usefulness to that. That could be something that could help determine what smaller filers need to do.

The next one is just a company specific kind of comment. It's a resource company. As you can see, their comments are very specific there in terms of disclosing validated resources. I just put that in there as an one off, but certainly continuing in the theme of disclosure, requirements and burdens.

Compliance costs. Basically, the comments here are that two audits are redundant. This commenter is looking-- he picked a number, $500 million, he wrote "market cap," maybe that's what he meant or market value public float, but roughly that number up from the $75 million, which in their eyes is just way too small in these public markets that we have here. It's an interesting comment.

A little bit on scaling, similar themes. One of the companies commented that the internal assessment part by the company itself was a great tool for them. They improved their internal controls, but of course, the outside attestation was something they could do without. Similar comment in that $75 million market value public float, way too low, and it just doesn't include enough companies.

The last thought goes back to sort of the old school accounting. I'm a former auditor. When you have got all these regulations, I always scratch my head. I always thought these were parts of regular financial audits, that this work needs to be done.

They write all public companies already have relatively extensive review of internal controls as part of the regular audit.

The next comment is also under scaling and compliance. An executive commenting on the 15 pages in a proxy statement to describe his $200 to $400,000 salary for him and the CFO. For that filer, that executive, it is just way out of line.

Comment on having a safe harbor similar to what we have in other areas. Maybe similar to ones we use right now for SOX 404.

In terms of governance, the second point there is just an issuer seeking more simplicity, additional simplicity, in terms of in this case what the various exchanges use to determine independence for board members.

Perhaps in that case, one size maybe fits all, at least for that executive.

I know within the NYSE and NYSE MKT, there are some slight differences between the two platforms that we run. In terms of capital raising, some comments, lifting caps, kind of the general theme, is favored by a lot of the executives, certainly by the executives that were responding.

A third point in terms of capital raising. They commented that the elimination of the prohibition on general solicitation is a blockbuster change, certainly that is a positive comment right there.

The middle point here refers to the independent research, if you will, sell side research, and their comment is simply that if the research were valued, it would be paid for. Who wouldn't want smart, great research, great intelligence, in terms of picking stocks? There is nothing more valuable than having that.

Somehow, they are looking for an environment where this can exist without the conflict similar to buy side firms. Certainly, they pay their own analysts, and they do, because those analysts' job is to produce investment recommendations for the portfolio managers.

There are good analysts out there. There is value to the work that analysts do. Somehow, they want to see where that model can fit to benefit small-cap companies that's not outside of an asset management model.

Some general comments. The second point there, we talked a little bit about this this morning, whether it's the economics of investment banks getting involved in start ups and IPOs or is it simply more an issue of regulation or a lack of investor interest that is causing the dearth of IPOs and the reduction in the number of small-cap companies that are traded.

It will take some work to try to get to the answer. They may not be mutually exclusive. It may be a combination of both. The question is are bankers turning down deals or are the deals not coming to the market?

Continuing on the general comment theme, the first one-- I'm amazed they even put that in. I think you have probably seen something like that, that SOX is incredibly burdensome.

The second thought was from a listed company and we heard a little bit about this in terms of making the JOBS Act accessible and offering relief for companies that have already come to the capital markets, and the thought is if there is a way to apply for an exemption, that would be welcomed, certainly by this company. This was about a billion dollar REIT that is listed on the NYSE MKT platform. You can sort listed companies by market cap.

Another comment continuing on the general comments. One of our wise executives also running another REIT wrote a paper. One of the themes were allowing companies to voluntarily-- he calls it "de-Sox," take Sox off, and if two-thirds or some number of the shareholders decide that's the way the company they own want it to be run, should be run, then the company certainly be entitled to do that.

You put out the disclosure. You let the world know, and the sense is that the market has a very good ability to assess and sort out those that are managed well and those that are not managed well, and those that have SOX or not.

It's summer time. We should all go "SOX-less."

In terms of the Public Company Accounting Oversight Board, the thought here was in talking to their auditors, this executive running a software company in Salt Lake City refers to the audits, the management, the management judgment, the permission to have a little more room for reasonable judgment as opposed to the audit firm being concerned about the PCAOB coming back and hitting that audit firm with a "gotcha" in these areas where there is client management judgment involved.

One of the suggestions there is that the audit firms should have an advocate to counterweight the PCAOB's public forums.

Litigation related comments. The themes here-- the first one is that when you see some companies announcing merger transactions, you have these immediate lawsuits. The point of this executive is the law firms are then entitled to fees, it's just a knee jerk response, knowing they are entitled and collect fees on this process, on what they do during these merger announcements.

We see these a lot nowadays, certainly with smaller cap companies, not long after a pending deal is announced, you see the announcement of an investigation by such and such firm. This is quite a thorn in the side of a number of our listed companies.

The second one is really in a sense a recommendation that the SEC should investigate allegations that involve misrepresentation before litigation is allowed to proceed. That would save companies time in saying this has no merit, if you will, and that would be the findings of the SEC.

Third thought is that these compliance costs are just embedded with a risk premium and they are incurred by the company, and they are passed along, of course, ultimately to shareholders and investors.

They are professional services firms, and they are all perceived to be at risk of lawsuits relating to disclosure and capital raising, et cetera.

That is something that exists. It's baked in nowadays and it's something that concerns a number of our CEOs.

In terms of the comments that would go under Advisory Committee comments, something I'm sure we have heard in terms of how SOX was rolled out, each of these deadlines looming large for these smaller cap companies, dedicating resources to meeting such deadlines and then each deadline being delayed and ultimately dropped. They were happy about that in general, but the idea that they had to prepare for each of the impending deadlines was something that was a concern to some of these executives.

The suggestion below that is that this Committee should be allowed to review and consider any draft rules impacting let's say this group of companies before the companies are required to be compliant with those rules. That is an interesting suggestion there.

Thank you. It was kind of random musings of listed-- these are the unvarnished comments from the listed company community, a wide range of thoughts.

I think a number of them were very well thought out, and I liked some of the suggestions as well. I do appreciate the opportunity to bring these before you, and hopefully some of them cause some dialogue and perhaps some activity around them. They would all be appreciated. I know that.

MR. GRAHAM: Thank you for that, Paul. That's exactly the sort of thing we do need, have input and information, it's very useful, certainly in the Committee's deliberations.

Thank you again to Jim.

I think one thing that we can all agree to is that many of the regulations, particularly for these smaller companies, but perhaps all companies-- the regulations do tend to be burdensome.

Maybe the answer is that we throw all this out the window and kind of rely on concepts like materiality and enforcement. Tell people that they can't lie, cheat, steal or mislead, otherwise, there will be serious consequences, and go on the basis of those principles.

I know that's not going to happen. When you look at the regulatory framework, it does seem like there is just a lot of regulation that can be streamlined or perhaps even eliminated because at the end of the day, you can look and say really, what benefit are they providing?

I would think the kinds of real life experiences that you hear about will help shed light on that set of regulations. By the time we get to the ones that are necessary, then you get to the ones that are streamlined, then you get to the ones that may be subject to the cost-benefit analysis. At the end of the day, maybe we can come up with a revised framework that really does ease the burden in a meaningful way. Any thoughts on how one proceeds from this point?

DR. ANGEL: The question is how do we proceed from here? I don't know exactly how the Committee is structured or what work product the Committee has. I'm not sure how the Committee should proceed.

MR. GRAHAM: Let me phrase that in a different way. As I think you know, the purpose of the Committee is to think about these broad issues, namely access to capital and regulatory burden, and come up with recommendations to address those issues broadly.

I guess certainly part of the question is how do you proceed to identify those regulations that might fit in those buckets? Which would lead you to recommendations to eliminate certain regulations? Which will lead you to streamlining others, and then you are left with kind of a third bucket, here's a set of regulations that really are kind of subject to a cost-benefit analysis approach as to whether they should apply to a particular company or not.

DR. ANGEL: Right. I think the clear thing is to focus on the biggest items first. For example, in the survey, things like the auditor attestation in Sarbanes-Oxley. The big items, I think, are clearly the most important to be faced first.

The Commission has already undertaken a retrospective review of existing regulations. I'm not sure what the status of that review is. I know the Obama Administration has pushed it forward, given all the other Dodd-Frank rulemaking and the Commission's dramatic lack of resources to do the job Congress has asked of it, I'm not sure how far along that has come.

MR. GRAHAM: I think there is something in the JOBS Act, too, that kind of addresses streamlining.

DR. ANGEL: Yes. One of the ways to do it is say what are the biggest items first?

MR. GRAHAM: Sorry to interrupt, Jim. In that context, we are there to try to actually help the Commission. In coming up with our own recommendations, as long as we have you here, I want to pick your brain for insight.

DR. ANGEL: Okay. Look at some of the comments that have come in, and also one of the things the Commission should basically be doing is reaching out, like it is to this Committee and to others, and say give us a list. We see it right here from Paul's survey. We see a number of concrete items that should basically all go into the report.

I've also given a number of items that I think you should look at, Sarbanes-Oxley, conflict minerals. Clearly, I like my own ideas, otherwise I wouldn't have them.

The idea of saying hey, let's have issuer choice in a lot of these areas. Let the issuers pick their tick size. Let the exchanges experiment. I think these are very powerful ideas that should be pushed strongly by the Committee.

As far as the letter of which part of Form S-1 should be cut, I'll leave that to others to be more concrete on that one.

MS. JACOBS: Could I ask a question?

MR. GRAHAM: The front half or the back half?

[Laughter.]

MS. JACOBS: I want to go back to both your presentations, and first of all, let me say thank you. As an existing public company, I had no idea this many people were working on issues that we live with every day. I really appreciate all of the work that you have put into your research.

I want to go back to something, when we were talking about-- you had a slide up there about the advent of SOX, and how the wording looked so simple. I'm having déjà vu because I looked at it and I said to the CFO, this isn't going to be too bad.

I'm like a million dollars down now. The creating of the type of internal controls, but I have to tell you what the dynamic is, our auditors and their relationship to the PCAOB and our attorneys, they interpreted SOX for me. I didn't create this.

I basically sat back and was modeled into place, and then had to begin to write the checks. In some cases, they're telling me the nature of my own internal controls and what is “material” or “significant.” I'm setting up my own rules and regs and am going to end up being the policeman on what is a significant deficiency.

I love what you're saying. They're going to probably have to bolt me to my chair on how many of these recommendations I would like to put forward. But, what's the reality with the dynamic of the Bar and our attorneys and our auditing firms and the PCAOB that this is allowed.

DR. ANGEL: I think you raise a point because SOX implementation was a classic regulatory train wreck. Congress put something in that seemed like-- I'm quoting some staffers who were here at the time-- “not that big a deal.”

What happened was this was just after the execution of Arthur Andersen, so the public accounting profession was very, very concerned about not following in the footsteps of Arthur Andersen, with a brand new regulatory body, the PCAOB, eagerly trying to do what they think Congress wanted.

The Commission at the time was really totally clueless as to the economic impact of what they were doing, that they under estimated the economic impact by a factor of ten if not a factor of 100. You put all those together, we had a regulatory train wreck.

The question is how do we repair the damage? Congress has in its own crude way with the JOBS Act started to slice off certain segments of the economy for it. I think there should be much clearer guidance from the Commission and the PCAOB to do things like say hey, all the law says is for an assessment. It does not specify any particular level of controls. It should be up to the market to figure out what level of controls the market wants. There should be several different levels of categories of controls ranging from COSO to mid-cap to small-cap. As long as that is well disclosed to investors, they should be able to choose. If they don't want to invest in a company with small-cap controls, so be it.

MR. DENNIS: I have a similar question to what Stephen and Christine asked, but maybe in a little different context. I really have two for both you and Paul. One on COSO. I hear your comments about different frameworks. When I look at the basic principles of COSO, I have a hard time not saying those shouldn't apply to the smallest company. I just wonder whether you had a different concept on COSO, whether it would just be COSO with a different name.

My real question, as I sit back and listen to everybody and what both you and Paul said, it seems to me that it's hard to always go backwards on regulations. You can take off little nicks and bites of it, but you never get back to where you were.

Not that I'm in favor of a separate exchange, but it seems to me like if you're going to do almost a radical start over with a defined set of companies, the first thing you have to say then is well, the investors have to know, right. That's probably not a ticker symbol on a New York Stock Exchange that says light. It's probably a separate exchange.

I would just be interested in your thoughts. Do you see us going down the road of a radical change, where you probably end up with a separate exchange with principles like Stephen laid out, of do the right thing or we're going to nail you to the cross, or do you see a better process being to take this defined set of companies and kind of nip around the edges, whether it be disclosures or say on pay, whatever that may be, and kind of nip a little bit at a time to try to scale them back? I am just curious to both you and Paul's thoughts on how radical do you see this going?

DR. ANGEL: Countries around the world struggle with the issue of how to provide capital to small- and mid-cap businesses. Exchanges around the world have launched incubator markets. They almost always fail in that they have a serious problem in that the companies that succeed jump to the major markets, and what's left behind are the failures. The incubator market develops a reputation as a failure market, and nobody wants to list there after a few years.

I think people are going to try all kinds of different things, and I think they should be encouraged to experiment and innovate. But, I think there is a serious philosophical problem with the JOBS Act and with a lot of the sort of regulatory thinking of the last decade, in which people have said whoa, the public market is too expensive and burdensome, so let's make it easier for people not to be in the public market.

For example, several years ago, the Commission did a rulemaking where they noticed wow, foreign companies want to de-register. Instead of asking the question why are they de-registering, why have our markets become so costly and burdensome that foreign issuers, big legitimate global companies, were lining up to leave? Instead of fixing the problem, they said well, let's have a rule filing to make it easier for them to leave.

I think we need to fix the major market. All the problems we have, they have a disproportionate effect on smaller companies, but they also have a big impact on larger companies as well. I think the real solution is to fix the entire capital market, not to say well, we'll raise the shareholder limit from 500 to 2,000, because then you have investors in a grayer area where they get even fewer protections.

We need to provide good consumer protection while at the same time promoting efficiency, competition and capital formation. It's a tradeoff.

MR. DENNIS: I agree with what you said until you have an MF Global, and then you change direction, right, or you have an Enron, and you change direction again. I don't know how you fix that big market unless you are willing to accept an MF Global happening every five years or something like that.

DR. ANGEL: Sarbanes-Oxley did not prevent MF Global.

MR. GRAHAM: What I was going to say, I don't disagree you have to fix the whole thing. Obviously, we are going to have to go about this incrementally. But, I would also push back a little bit on the notion that a completely separate exchange is a bad idea. I don't know that I necessarily agree with that. It doesn't have to be the failure exchange, I don't think.

Certainly, the way I would see it is there is a progression, from a private company to an exchange where only accredited investors are permitted to an exchange, like we have now, it's everybody, including retail, and all the protections to go along with that.

DR. ANGEL: Let me clarify what I said. I didn't say a small exchange was a bad idea. I think exchanges should be allowed to experiment and innovate. We need to get away from the one size fits all model of exchange regulation. It really frustrates me to see how the proposals from NASDAQ and New York to sort of do things in the small-cap market, sort of get changed by staffers here in this building so that at the end of the day, the small market looks just like a mini-copy of the big exchange.

If all you do is have a junior market with exactly the same procedures and trading platform and rules and disclosure and everything as the big market, the only difference is the listing standards.

Those are the markets that fail.

I believe that given American innovation and entrepreneurship and creativity, somebody will come upon the right formula, but they have to be allowed to try it out. Unfortunately, the one–market-fits-all mentality that exists in this building is really causing this crisis in capital formation.

I've had former senior staffers basically tell me they don't think companies should go public because the IPOs are bad. I think that kind of thinking we have to get away from.

MR. DORFMAN: I'll be quick. We at the NYSE--

MR. GRAHAM: Take your time, Paul.

MR. DORFMAN: Okay. I won't be that quick anyway. I always just say that. I never am.

We at the NYSE obviously-- three years ago, the New York Stock Exchange and Euronext acquired the American Stock Exchange and integrated that into the technology, the oversight, the requirements of what we now call the “DMMs,” the designated market makers, specifically for the small-cap, really micro-cap, nano-cap, whatever you want to call it, really tiny, tiny companies. It is now full part and parcel of the NYSE Euronext family. One of the things they got when they acquired AMEX was this great list of micro-cap companies.

The exchanges are looking for ways both as an SRO and as a for profit business to reach into new markets and attract new customers, listed companies, order flow providers, what have you.

We are trying to be creative there. We are creative. We constantly think of new ways to advance the interest of the micro-cap community.

Then you think about things like order flow and trading in some of these small-caps, and the markets are already so fragmented in terms of getting good price discovery, especially for micro-cap stocks is not that simple.

The rules around Reg NMS make it challenging for the participants on the Floor to be as involved as they want to, and then to some extent, to a decent extent, it frustrates the listed company executives because they get calls from their shareholders asking what happened in the stock today and why did it happen, it happened on 35 different platforms. To have another participant in terms of an exchange or just a listing platform or what have you may only just further fragment the market. Hopefully, if there are some things to be done in that area, NYSE Euronext and NASDAQ can do those things.

One of the things I will add is that with all the micro-cap companies are going through in terms of their cost of capital and the outlays, they are an incredibly resilient bunch. I'm struck since SOX and on and on, in the last decade or so, how many of them have continued to remain in the public markets-- Ohio Art notwithstanding. They were on AMEX.

While they are frustrated, they are also continuing every day to run their companies, to use the capital markets, to see the glass is half full, if you will, easier to raise money and to be visible and to enjoy the benefits, the pros and cons of having analysts cover them if they are fortunate enough to have one. It is one of the great advantages, I think, of being public, you have people constantly telling you what to do for free. That is why I think a lot of companies like those, and it is really underappreciated, I think.

Anyway, that's a thought on terms of being radical or working around the edges. I think working around the edges certainly from our point of view is a good way to go.

MR. GRAHAM: Thank you for that. I'd also like to kind of push back a little bit on the notion that people are of the mindset that one size fits all. My sense is that no one on this Committee and probably very few in this room thinks that any more. We have made progress with respect to the small reporting companies. There is a whole new concept in the JOBS Act for emerging growth companies.

The more people that focus on these issues, the more people kind of understand that certainly one size does not fit all, and the real question again kind of goes back to okay, how do you deal with that? We know there is an issue there. We know one size does not fit all. How do you really kind of solve that problem so you can kind of bring back smaller IPOs and the other things we are trying to accomplish?

DR. ANGEL: How do you solve that problem? Well, personally, I think that people sitting around this table get the problem, but our regulatory apparatus is quite large.

If you look at a lot of the rules coming out of FINRA, they are basically trying to turn the over-the-counter, OTC, space into a mini version of the NMS market. I think that is a mistake because a lot of the smaller cap companies there would really benefit from a different market structure.

The real question is how do we change the regulatory thinking? We have Commissioners who come and go, for limited term appointments. We also have staffers who are here for decades. How do we get the staffers to be thinking well, we can't treat every company like an S&P 500 company? That is a very difficult managerial task for the Commissioners.

CHAIRMAN SCHAPIRO: I just have to respond.

DR. ANGEL: Yes.

MR. GRAHAM: I was going to call on you, Mary.

CHAIRMAN SCHAPIRO: I think that is profoundly unfair to the SEC staff. First of all, we have lots of examples of scaled disclosure. We have lots of examples, in fact, we recently approved an alternative venture market that NASDAQ had applied for.

DR. ANGEL: After lots of SEC staff work that basically made it look just like the large-cap market.

CHAIRMAN SCHAPIRO: I guess I don't agree with that. Beyond that, we also have an issue of investor protection. We don't have the luxury of looking at things just from the perspective of the company.

We believe in IPOs. I've never heard anybody here say that. We actually love IPOs because we love public, transparent, lit markets where everybody can participate much more than we like small, private dark markets where only accredited or highly qualified investors can participate. I think it's important now for everybody to remember that we also have to look at the other side of it, and the other side of it is the investor.

The other side of it is the analysts. We would all love more analyst coverage, but if there's no information, there won't be analyst coverage. So, we have to have information in the public marketplace in order to get analyst coverage. We have to ensure that investors have access to information that allows them to make rational decisions, because as we know from failed ventures like the emerging company marketplace at AMEX-- I was here when we approved it 20 years ago, I was here when we shut it down because it was rife with fraud.

We have to find a way to get the balance right. We absolutely want to encourage small companies to go public, to be able to stay public, to be able to bear the costs without too much burden of regulation. We also want to make sure that investors keep coming back to that market and keep buying those stocks because they feel like they have what they need to make rational decisions to buy and to sell.

It troubles me to hear these broad sweeps about the SEC doesn't do this or the SEC doesn't believe that. The reason you all are here is to help us figure out with some granularity what are the things that really aren't adding any benefit to investors, and I know there are some, maybe there are even many. They can take a burden off small and medium sized companies. I'm sorry. There came a point where I just had to react.

MR. GRAHAM: Yes, Richard?

MR. LEZA: Since everybody is pointing fingers at different entities, I'd like to point one myself.

MR. GRAHAM: Let the record show, Richard, I have pointed no fingers.

[Laughter.]

MR. LEZA: Yes. I've been involved for 35 years in nothing but either start-ups and the biggest company I've ever been involved with, $150 million in revenue. I've always been in that area.

When SOX came out, I thought when I read that thing that it was simple. Well, this shouldn't be a problem. One of the companies that we had was making $150 million in revenue. We started implementing this. We thought it was going to be pretty simple. As soon as we started, pretty soon, we got two people that I think are of the biggest culprits in this thing, CPAs and lawyers.

We started doing this, implementing some things, and they said oh, you must do more than that. You must do this, this, and this or they're going to de-list you. We went from 250 internal controls that we had in our company, never had any problems, this particular company, we went to 675 under the guidance of CPA firms and the lawyers. We went through that.

You can imagine, a company of $100 million in revenues going to 675 internal control points is ridiculous. But, every time you make the argument, oh, you're going to be de-listed. This is what the law says. Well, that's not exactly what the law says. We kept jumping and jumping. After four years, we are down to 275 internal controls.

The real culprit in this becoming so expensive, so complex, stuff like this, to me is two people, they get revenue out of this, lawyers and CPAs. It's not the SEC. It's not other people. It's not investors. It is those two entities that make money out of making things complicated and making sure they go from 250 internal controls to 675, and it's just totally ridiculous.

MR. GRAHAM: You're not suggesting that all lawyers are that way, are you?

[Laughter.]

MR. LEZA: Never.

MR. BOCHNOWSKI: Steve, if I could echo that. I think the problem is, and I am a lawyer, but not a securities lawyer, but to the point that you've made, the auditor will do their attestation, but then it has to go up to their review auditor, or the business lawyer will make his judgment and it has to go up to the securities lawyer. There is a double layering of costs in there that really drives-- it is not the SEC that is causing the cost, it's the attendant costs that are really doing the damage.

MR. GRAHAM: I think it's a complicated issue. Certainly, I assume you didn't keep those two guys, did you?

[Laughter.]

MR. GRAHAM: One thing that drives this and I think you're right, at least at some level, that lawyers can be the culprit. I think this gets to the point of where there is just no easy answers. Certainly, a big part of the problem is you have other lawyers that will sue at the slightest provocation or at the slightest excuse, and then in preparing a company to defend those kinds of suits, other lawyers kind of recommend layer upon layer of protection, if you will.

Absent a rule that might suggest a lower level of disclosure is permitted or might be considered appropriate, I think what you might often times find are situations where the only thing going is what other companies are doing. The last thing you want to do is find yourself in a situation where you are sued, and I would venture to say the vast majority of these kinds of strike suits are without merit, but nonetheless, when those things happen, one of the things that is going to be looked at-- are you doing what everybody else is doing?

To the extent the argument can be made that you're not kind of living up to the industry standard, if you will, then that's going to be problematic. That situation is not the fault of the regulators, as you say. It's the fault of some of our professional colleagues. I think the regulators could help by actually implementing specific scaled disclosure, a specific rule which says in this context, this is all that's required.

DR. ANGEL: I think you bring up a really good point about the legal situation. I just wanted to emphasize one of the points Paul made. I'm not now nor have I ever been an attorney. But, my understanding is a lot of the litigation has to do with 10b-5. Is there anything the SEC can do that can basically help to prevent or clamp down some of that litigation?

The idea here that the SEC should have to make a finding of some kind of wrongdoing before the litigation takes place, to me, sounds like an excellent one. I don't know if that will require legislation or whether that can be done under existing authority. I think we should recommend such legislation because clearly, the amount of baseless litigation is a huge drag on our capital markets.

MR. ABSHURE: On behalf of attorneys everywhere, I would say the Private Securities Litigation Reform Act took care of that.

DR. ANGEL: Then why is there still so much litigation?

MR. ABSHURE: Compared to where it was, I would say there's not as much. I think the limitations that are contained in that Act with the pleading requirements and the discovery are more than adequate control on litigation running rampant.

MR. GRAHAM: Let's not slip into a debate on what litigation-- the litigation environment. I will say that I don't recall-- I would have trouble thinking of an M&A transaction that I've been involved with in recent years where there was not litigation. People just sue. It just becomes a tax on the deal. I think that is something we have kind of learned to live with.

MR. DENNIS: Stephen, I would just add I don't think it's necessarily the litigation itself that's the cost. It's the threat. It's the perception, whether it's real or not, that I will be sued as a public company so I better do everything that everybody has done, plus some.

It's the perception that the auditor is going to get spanked by the PCAOB, so I better do what my competitor did plus more. All that added to drives costs. It just keeps multiplying. The PCAOB has some great people, they do a good job. Their job is to find issues. They do. When you find issues on one client or one inspection, that multiplies because now the next time I'm going to do that for every client I have. Then I'm going to look at my competitor's report and see what issues and I'm going to do that on every client.

MR. GRAHAM: These kinds of problems, I don't think we are going to solve.

MR. DENNIS: You almost have to have something radical that says this is completely into a new regulatory scheme.

MR. GRAHAM: Often times, the issue is lack of judgment on the part of the person giving the advice. Instead of really kind of understanding the unique set of circumstances, they kind of take the "cover your rear" approach to things and just say put it all in and no one can blame me. Shannon, you must have something to say.

MS. GREENE: I do. I've got to leave here in a minute. My disclaimer is we're a small nano -- beyond smaller than nano-cap stock. Our market cap is about $50 million, $70 million in revenue. We are in five countries. We have 500 employees. Shouldn't be public, so everybody says, well, why the hell are you public. I got it. We did it in 1993 via a reverse merger. Okay.

I know we shouldn't even be public but we can't figure out how to get out of it now. Sarbanes-Oxley, I understand it was a reaction to Enron, but I have talked to enough prior SEC staff. They are probably not here anymore, that said Sarbanes-Oxley would not have stopped an Enron, that wouldn't have stopped WorldCom, it wouldn't have stopped MF Global.

Why doesn't somebody stand up, instead of talking about the costs and who is making money on it and how hard it is on everybody, why doesn't somebody just stand up and say you know, it's not effective? Particularly with small companies.

I've not had one investor call me and say so, how's your internal controls, and how's your assessment on Sarbanes going? Never had one investor. I am a huge anti-Sarbanes-Oxley person, not just for small companies. We are exempted at the moment because our market cap is where it is. I don't think it's helping the big companies either.

Those of us that are doing it right pay the price for it. Those guys that are going to do it wrong are going to do it wrong regardless of what the laws are and what the regulations are. Sarbanes-Oxley, I think, looking back, is not effective. I don't think it's effective now. That's my deal on Sarbanes. It's expensive and ineffective, particularly on small companies.

XBRL, not as expensive. The implementation wasn't as bad, but again, I've never had anybody call and say hey, you know, I can't seem to line up your tagging with somebody else. Who is using that? We're so far off the radar screen, I don't think anybody even looks at our stuff. Say on pay? My CEO makes $180,000 a year. Anybody who wants to fuss about that, come in and talk to us about it.

Everybody we talk to says you guys ought to be making more money. Okay. We're going to do that, too, but that was to get the CEOs that are making millions and millions of dollars running really poor companies, I think. It was a hot button and I get it because there are CEOs out there that were being paid way too much money to not run good companies. Again, we're so far off the radar screen and so under paid, that's not helping us any, but it is costing us money.

Our comp committee has now hired executive comp study people because that's what you do now. You have got to have some reason for why.

As a public company now, scaled back disclosure, I don't know how that would help us any. Two years of statements instead of three, we are already doing three. We have been doing three for a long time. That's not going to help us any. Fewer footnotes. We have already written them all. We already have them all. I don't see-- new disclosure requirements or whatever, that might be a big deal. I can't imagine. We are pretty simple. I don't see what being a public company and getting breaks on disclosure-- we have already done all the work. If we had to have experts come in, we have already done all that.

I think what is most painful is all the stuff we were talking about this morning, which is we have a very illiquid stock. We are not going to get attention because the analysts can't make any money on it, the traders can't make any money on it.

The spread and all that, I'm one of those, I don't know-- if we had to set it, I don't know. I have no idea what that should be. I don't care what it should be. The bottom line is supply and demand, advertising, marketing to potential investors. There is nobody out there doing that for us because we're so small and everybody is in it to make money.

Traders can't make any money because we don't trade enough. Research-- ten years ago we had five analysts. Now, we have none. I don't know that we will ever get any. We don't offer enough and we don't have a deal. Investment banks, we don't need money. We don't have a deal to do. There is no way for them to make money to help us get to more investors or whatever. The road shows, the small one on one meetings I do with potential investors. We have a good story. We are financially sound. They say we love your company, but we need 250,000 shares to even get in, and that will take us a year. Thanks, but sorry. There is nothing I can do.

The pain of small companies, all the regulation and the disclosures and all the stuff we do, probably wouldn't be quite as painful if we were getting the benefit, and it's not raising capital. We have cash, we don't need that. But increase your value, stock moves up when you perform well. That's ultimately what we're in there for, I think.

That doesn't happen because nobody even knows we exist and aren't going to know we exist because you can't get an analyst to pick you up because they're going to lose money by putting any kind of effort into you. The stuff this morning, I don't know that anybody can do anything. I don't know what the solution is to fix any of that. We have to realize in the race we're in, we're coming in last or next to last, and the media doesn't want to talk to the guy that finishes last. He wants to talk to the top three. That's where all the excitement is. We just kind of pull up the rear and spend an awful lot of money because we're in the game. Again, I go back to my first comment, we shouldn't be, I suppose, and that is another discussion for another day, but we're trying.

New companies coming in, I don't care, ramp up five years whatever. I would look at every company and say you need to think really hard because unless you have a hell of a story, the analysts are going to fall off eventually. The first time you hiccup and your stock price goes down, they are going to drop you, and good luck ever trying to get back in there.

Unless you have got a huge growth story-- Facebook was going to be it, although that didn't go quite as well either. If you're not a Facebook, don't bother. They did. If you're not that, how many of those come around? Not that many that often.

I would discourage anybody, small company, from getting in the game. Even if it's really cool for the first couple of years, you lose all your momentum and then you're just struggling to stay in it. That's not an SEC issue. That's an overall market issue. I don't know the solution other than don't be public if you're not up there in the top 20 percent of the class or whatever.

MR. GRAHAM: Jim, you thought she worked for the SEC.

[Laughter.]

MR. GRAHAM: Paul, do you have any response?

MR. DORFMAN: Well said. This is what I hear. I work with listed companies a lot. I remember you from way back.

MS. GREENE: Let me interject that we listed on AMEX. We were with AMEX up until two years ago, had the specialist. I'd call and say gosh, you know, a block traded today. What is it? First of all, he wouldn't have even noticed because his book, we are down at the bottom. When he does look at it, he goes, I can't really tell, it didn't trade on the exchange, I can't really tell you.

Then we moved to NASDAQ. We are on Global Markets or whatever. Supposed to have three market makers. I have no idea if they do anything or not because nothing in the activity has changed at all. Nothing.

MR. NALLENGARA: Professor Harris this morning mentioned a proposal that we have heard/read about, of companies of your size paying for that, paying for someone to make a market or having someone do what you say no one is doing. Is that something-- how does that sound to you? We haven't really talked about this here. It is something that Professor Harris mentioned. I'm sure you haven't thought about it.

MS. GREENE: I haven't. It's the first time I had heard anything about it. My first reaction would be we don't like to spend money on anything that we don't have to. Again, to spend money lowers profits, which affects financial performance, which ultimately you are fighting the shareholder value or the stock price. I guess it would depend on what it cost and what kind of expected results are you going to get.

NASDAQ's listing, to be listed on the platform that we're on, three firms had to sign letters that-- they may do something every day. I don't know. I've never talked to them. We just don't trade enough. I don't know. What kind of money are we talking, and what would it do? It's not a pump and dump thing. What are we paying for? If it makes the volume increase by 25 percent, maybe. I don't know.

MR. NALLENGARA: Paul, I'm sure you have talked about it. Any thoughts? I know you were not here for Professor Harris' chat.

MR. DORFMAN: I was here. I was in the way back. I was in the audience, minding my own business. NYSE Euronext actually makes liquidity payments to our designated market makers today. It is not my area, I'm not an expert. In the general sense, we absolutely do that today. They are based on their quoting and participation. The more aggressive quoting the DMM makes, right, we used to call them "specialists." The more times their bids are hit or offers are taken, they get a rebate or a liquidity payment from us.

To some extent, that mechanism is in there, and what we are doing is incenting our market makers, our DMMs, they are not generic market makers, to do this. Other markets don't do that. We do. It's not coming from our listed companies. It is something that we do. We do it because in theory the better the markets, the tighter the spreads, the more order flow would come to us. That is done.

Shannon, what is your P/E, if I may ask, in terms of price and earnings?

MS. GREENE: 10 to 12.

MR. DORFMAN: The companies we looked at, the sub-$250 million public float, they had a P/E of 13. That's pretty close to the Russell 2000 companies, although these companies were smaller than the Russell 2000 companies. Your P/E is a little bit below what ours are-- what we found in our 1,900 plus companies. You do have analysts, they are just on the buy side. There are managers out there scouring public companies large and small, and they employ analysts. I was one once. Today, they look at companies and they are paid to do it. They make recommendations to portfolio managers.

When they find compelling stories, whatever it is, sometimes they enjoy looking at small micro-cap, overlooked stocks, because they may trade a little lower, and yes, it does take longer to get into a position, but the analysts are out there. They're not writing reports externally, but they're writing reports internally.

With the systems the buy side firms have today, they are able to scan incredible amounts of data on all public companies, certainly national exchange listed companies, and they filter these things out in minutes. When something jumps out in terms of evaluation or yield or what have you, fundamentals, the balance sheet and P&L, that company will get noticed.

MS. GREENE: You still have the issue of getting noticed. Then they look at you and go, oh, you're trading 1,000 shares a day. I get calls from firms. We are almost 60 percent institutionally held, which for our market cap size is like the largest, to have that kind of institutional holdings. Again, I get calls probably several times a month from new firms that are interested because we have hit some screen or whatever. Then they are like gosh, you're just so small. The question through the conversation eventually comes up, why are you guys even public? I know, I know. We shouldn't be.

MR. CHACE: There is definitely a threshold from the institutional investor side, where if you're below a certain cap range or a certain liquidity, there's no point in bothering. The fact that the economics of covering a micro-cap liquid stock from the sell side are not worth it. There is also from the buy side a point where you know-- like you said, it would take you a year to buy the stock.

If you're a $50 million cap, we are a $300 million fund, the math just doesn't work in terms of how much of the company you'd have to acquire to get a meaningful position. I do think there is certain-- we kind of use $100 million as a threshold. Below $100 million, it can get really hard. There are other sort of stages along the cap spectrum as well where there are kind of these break points really, where it becomes easier and more logical to pursue something.

I do think some of these proposals like the tick size, the sort of subsidies, I think you would be kind of pushing on a string if you're as small as you are. Maybe from 200 to 500, you benefit to some degree, but there's a limit.

DR. ANGEL: I would like to throw out a suggestion for scaling Sarbanes-Oxley. That is to do some scientific rational rulemaking. The JOBS Act exempts very small companies. Why not take the next segment, say everything under $1 billion market cap. Run a pilot experiment. Take half of them, waive the attestation requirements. Let that run for three to five years to collect the data. Then see what it costs. Also look at the impact of the capital markets. Look at transaction costs. Look at restatements. See what was the benefit of the companies with the requirements and without the requirements.

I don't think anybody will sue you for conducting such a pilot, other than if they are one of the companies left out of the pilot class. Also, you could probably argue that the authority to do consumer testing might be extended to that, and you are looking at how consumers respond to the different qualities of financial reports.

See what happens. Actually do serious controlled experimentation, as was done with the short sale pilot. That was probably one of the best examples of how to do scientific, rigorous rulemaking to collect data to actually look at the impact of the regulations. I would say do an experiment. Take a bunch of companies, a large number, a statistically large sample, waive the rule for long enough to collect the data, and then see what happens.

MR. GRAHAM: Kara?

MS. JENNY: I just wanted to say that I'm probably a registrant similar to Shannon, probably a little bit bigger. I agree with a lot of what she said and face a lot of the same challenges. One thing I will say is there are a lot of issues that you both brought up in your presentations that I do think are sort of low hanging fruit and are things that while yes, we follow SOX and we do all the procedures we need to do, I never thought XBRL was going to be a problem. In fact, it's not a problem. It's an expense, but it's not a problem.

Until I realized or you have to realize, we are as CFOs and CEOs, we are running our business every day. In addition to compliance, we have a business to run. Sometimes in scheduling earnings calls or deciding when you're going to release, you all of a sudden have to now stop and say oh, my God, I have to back up three days because the most cost efficient way for me to get on XBRL is to use this provider who will take four days. That's the cheapest way to do it.

I have to plan an entire earnings calendar around that. While I don't think that everything needs to get rolled back, or I agree there are a lot of challenges we have to address, I think certain things like one of the ones mentioned in one of your presentations about would it be the biggest deal if companies of a smaller size didn't completely roll out XBRL until the week after they released, or five days after, five extra business days.

There is a lot in what you both presented, it's a spectrum. I think you can go one way or the other. I think there is a lot of things that as a registrant that is on a much smaller side that would be very helpful to us. I think there is a lot of good information in there that we really should explore as a Committee.

MR. GRAHAM: Good points.

MS. JACOBS: Can I jump in and add to that? I've got a very real example. When we fell below the $75 million market cap and we got the reprieve from CD&A, that is like 25 pages off the proxy. It was amazing. I said I can go to cheaper paper this year now.

Just these little things, like you asked the question, what did the proxy cost this year? What did the annual report cost this year? I agree. I think there are incremental things that can be done that would give us relief.

I cannot sit here and say the sun is not going to come up tomorrow. If I did, I shouldn't be sitting in my chair. I have to believe that we can help make a difference, and while we are at it, I'll say my final comment, if you don't mind, Co-Chair. There is an opportunity here with the 2,000 public companies for the Commission and the exchange to consider.

We already comply. There is already a track record on us. We are not the Enrons. We are not the MF Globals. We are creating jobs. We are attempting to innovate, and whether it is tick size, I'm not big enough or smart enough to be able to identify where the problem is, but I'll take any life line that you all want to throw at us. That $75 million market cap was huge for the reporting companies, for the small public guys. That is a great starting point on the back of the JOBS Act.

We're going to ask for and hope to receive a level playing field. The JOBS Act gave a lot of reprieve to the incoming IPOs, but we had this 2,000 company basket that to me, I won't say it's risk free, but it has risks associated with it that are much smaller than an incoming or a new IPO. We're known entities. When it comes to giving us scaling reprieves and some help, we should be a population that you really can count on us. We are already complying. I am with you. I'll take whatever we can get.

MR. NALLENGARA: I know we were looking at this meeting as a learning meeting. As something for the Committee to consider, to take Kara's example and build off that, of low hanging fruit. We talked about some of the higher ones, the tick size and market structure issues. Those are things that are hard to distill down into a recommendation as compared to identifying some of those items that there can be some modification to the existing framework that is more easy or relatively speaking, easier for us to consider and make a recommendation to the Chairman and the other Commissioners.

DR. ANGEL: As a consumer of financial data, I love XBRL, and I look forward to the day when all financial data is in XBRL, and I can just sort of grab it and manipulate it, but I don't need to have it in real time. If there is a lag of a week or two before the XBRL is ready, that's fine.

I have nothing against having small companies having delays in XBRL. It doesn't necessarily have to be audited. If there's a mistake, any user of real databases knows there are mistakes, they will happen, as long as there is no intent to manipulate or defraud, so what?

I think eventually the accounting packages should be able to spit out XBRL reports. We are not there yet. We should take our time and roll out XBRL in a rational, common sense, cost effective manner.

MR. GRAHAM: With that, I think we will end our panel discussion at least. Thank you again, Paul and Jim. The promised end time for today's meeting was 4:00, and 4:00 is approaching. I just wanted to take a couple of minutes and talk about what happens next. Paul and Jim, you're welcome to walk out or just sit tight.

As was said at the beginning, and Lona just reminded us, the purpose of today's meeting was to really again recalibrate, get information, learn some things, add to the context of our decision making. I think the day went very well in that regard. I think we achieved what we set out to achieve.

Again, thanks goes to you guys, Gerry, Jennifer, Lona, and the rest of the SEC staff.

What we will do is try to distill some of the things that have been said today, and probably not come up necessarily with a set of recommendations, but at least come up with a set of ideas where we should be looking in terms of future recommendations.

Whether there are actual recommendations or something that is less than that, we will eventually get that out to the Committee so that you can begin thinking about those issues in anticipation of our next meeting.

Our next meeting will likely be in September. I think we have a date tentatively set, September 6. We don't have a location set yet. We are looking into various logistics. Once again, it will be here in D.C. or San Francisco. We will let you know as soon as possible so people can make plans.

I think that is all I have in terms of next steps and closing. Thank you all again for coming. I know some of you just maybe jumped on a train or jumped in your car and came, and other people had to jump on planes and travel a ways. Appreciate you being here. Lona? Chris?

Anything?

(No response.)

MR. GRAHAM: Okay. You're excused.

The meeting was concluded at 3:52 p.m.