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SMALL BUSINESS CAPITAL FORMATION

RECORD OF PROCEEDINGS

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SEC Division of Economic and Risk Analysis

Michael L. Zuppone, Partner,
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R. Cromwell Coulson, President and CEO
OTC Markets Group, Inc.

A. Heath Abshure, Arkansas Securities Commissioner
Little Rock, Arkansas

Keith F. Higgins, Director
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Panelists (in order of presentation):

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SEC Division of Economic and Risk Analysis

Prof. Donald C. Langevoort
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Jean Peters, Board Member
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Golden Seeds Fund LP

A. Heath Abshure, Arkansas Securities Commissioner
Little Rock, Arkansas

P R O C E E D I N G S

Call to Order

MR. GOMEZ ABERO: Good morning. We would like to go ahead and get started, so we'll give you a few minutes to get to your seats, and then we'll get started here. Thank you.

Good morning. Welcome to the 33rd Annual Small Business Forum. My name is Sebastian Gomez. I am the chief of the Office of Small Business Policy in the SEC's Division of Corporation Finance.

This forum is being conducted by the SEC under its mandate under Section 503 of the Omnibus Small Business Capital Formation Act of 1980.

Before we begin the program today, I wanted to give the standard SEC disclaimer on behalf of each person from the SEC who will speak today.

The views they express are their own and don't necessarily represent the views of the Commission or the staff of the Commission.

I also want to express my sincere thanks to the Office of Small Business Policy, the staff in the Office of Small Business Policy, and the staff in the Division of Trading and Markets for their tireless efforts to put together this forum, especially the work of Tony Barone and Amy Reischauer. Without Tony and Amy, we would not be here today.

We will give short introductions of each Commissioner and panelist, because fuller bios for everyone appear in the program that you received this morning.

For those of you watching the web cast, an electronic version of the program is available on the web page for the forum.

I would like to now introduce Keith Higgins. Keith joined the SEC last year as the director of the Division of Corporation Finance. Keith came to the SEC from the law firm of Ropes & Gray, where he practiced law for 30 years.

In his relatively short time here at the SEC, Keith has been actively leading the Division staff on a number of initiatives, including many issues relating to small business capital formation.

Keith.

Introductions of SEC Chair and Commissioners

MR. HIGGINS: Thanks, Sebastian, and welcome, good morning. Good morning, everyone. Welcome.

I'd like to thank you for taking the time to come -- to share your views and your experience and insights both with the staff and with the Commissioners, who are here today. I'm sure it's going to be an exciting event.

The topics that we'll discuss today are not only very important to the Commission, to the Division of Corporation Finance, Division of Trading and Markets, but also the Commission, the economy, our markets as a whole.

I know it's going to be an interesting day, a lot of good topics to discuss, and we look forward to hearing the views not only of our panelists today but also of all of you in the breakout groups that will be held later this afternoon.

As Sebastian noted, the views that we express, the staff express, and certainly, the Commissioners, are their own, and I'd like to particularly say Steve Luparello who will be moderating -- co-moderating one of the panelists and -- the others.

We might, in fact, ask questions or make statements that don't even necessarily reflect our own views but are done to -- to elicit a little bit of spirited dialogue. I hope that whatever questions we ask will be -- will contribute to a meaningful -- meaningful and constructive discussion.

Before we start, I'd also like to -- I know Sebastian thanked the folks in his office, but I'd really like to acknowledge the hard work that was done by Sebastian, who has, for just about a year, almost a year, been our chief of the Office of Small Business Policy in the Division of Corporation Finance.

As many of you know, that office is the SEC's main contact point for smaller companies, both public and private. In addition to organizing events such as today's forum, the office is the liaison to the Commission's Advisory Committee on Small and Emerging Companies, which the Commission recently renewed.

It plays a key role in the Commission's rulemakings under the JOBS Act, and on a day-to-day basis, does a great job of helping smaller companies and practitioners understand better the opportunities for capital formation for smaller companies.

So, thanks, Sebastian, and everybody in the office for all the work that you've done.

With that, I'm pleased to start the forum by introducing Chair Mary Jo White.

Chair White became the 31st chair of the Commission in April of 2013. She arrived at the SEC after decades of experience as a Federal prosecutor and as a securities litigator.

Most importantly, besides bringing both a sterling reputation and a great resume to the Commission, Chair White has brought a practical, common sense approach to securities regulation and a deep commitment to the mission of the agency, protecting investors, facilitating capital formation, and promoting fair and efficient markets.

Chair White?

Remarks By SEC Chair and Commissioners

MS. WHITE: Thank you very much, Keith, and I think, after all those disclaimers, you can now ignore everything all of us say, which is only fair, but seriously, I want to reiterate the welcome to everyone today.

I especially want to thank all of the panelists and the participants in today's program.

You all really do serve as our eyes and ears in the small business community, and giving us really critical insight into the impact our rules have on small businesses, and we are always eager to engage in discussions with you and benefit from your recommendations.

I also want to thank Keith and Steve Luparello, who will be here later, and their staff, Sebastian et al., from the Division of Corporation Finance and the Division of Trading and Markets, for organizing today's forum. It's very important to all of us.

You know, you don't need me or any of us to tell you that small businesses play a crucial role in the growth of our Nation's economy and the creation of new jobs for America.

Today's event is actually the SEC's 33rd Government Business Forum. Each year, we gather with leaders of the small business community to learn more about the needs of entrepreneurs and small business owners and the impact our rules are having or could better have on their efforts to raise capital and grow their businesses.

The open and direct discussions, which really are the hallmark of this forum, have resulted in many thoughtful and creative recommendations for reducing regulatory impediments for businesses seeking to access the capital markets.

You know, just as a point of reference, some of the forum recommendations that the Commission or the staff has acted on in the last decade include: simplifying the disclosure and reporting requirements for smaller companies and allowing smaller companies to provide less burdensome scaled disclosures, shortening the holding periods for re-sales of securities under the Rule 144 safe harbor from one year to six months for reporting companies, exempting compensatory employee stock options from registration under the Exchange Act, providing a transition period for smaller reporting companies from the say-on-pay and frequency votes required under the Dodd-Frank Act, and developing a pilot program to assess the impact of tick size on market liquidity for small cap companies.

So, that's just a sample, but I think it shows you just how important those recommendations are, and as you know, today's forum will also explore a number of important issues that affect small businesses.

Our first panel will address the very important subject of secondary market liquidity for securities of small businesses.

The JOBS Act sought to promote capital formation for small businesses by changing the initial public offering process for emerging growth companies and expanding the options for unregistered offerings.

Now, while these changes are designed to facilitate smaller companies' ability to access the capital markets, investors in these offerings may face liquidity challenges which would place their investment at risk. These same challenges could also constrain the positive potential that the changes to the offering process could have and were designed to have for small business capital formation.

So, we must therefore consider these liquidity challenges really both in terms of the impact on investors but also on the ability of small business issuers to access the capital markets in the first place.

So, we very much want your feedback and your ideas in this area.

The second panel will focus on the accredited investor definition, a very important subject for us and for you.

As you know, the Commission staff, including the staff from the Division of Corporation Finance and the Division of Economic and Risk Analysis is, as we speak, conducting a comprehensive review of the accredited investor definition as it relates to natural persons.

The goal of the review is to assess whether we are properly identifying the population of investors who should be able to purchase securities in securities offerings without the protection afforded by the registration requirements of the Securities Act.

A critical part of the staff's review is soliciting and considering input from the public and other interested parties, obviously and importantly including those of you here today. So, we are very anxious to hear your views on this important topic and get your insights.

After the morning panel discussions, as is the tradition of the forum, we will ask you to join breakout groups to discuss and draft specific recommendations on the topics that are covered in the two panels, and we're also going to be asking you for recommendations on the disclosure effectiveness review that the Division of Corporation Finance is undertaking and on exempt securities offerings, and again, let me emphasize how very interested we are in the recommendations that you make today.

As we assess your recommendations, we always consider carefully the impact that the suggested changes would have on investors both in terms of what risks they face but also whether the change would serve to attract investors to small business investing.

Obviously, regulatory changes that compromise investor protections or raise concerns for investors about investing will ultimately cost the small business community more than any benefit derived from the proposed change.

Investor confidence, confidence in small business investing and in the fairness of the capital-raising process is an important guide as you discuss, test, and formulate your recommendations today and as we consider them going forward.

You know, it really is the marriage of investor protection and better ways to facilitate more capital formation that makes our markets, rightly, I think, the envy of the world.

So, I very much look forward to the output from today. Thank you again for your efforts to help us improve the ability of small businesses to access our capital markets.

Thank you.

MR. HIGGINS: Thank you, Chair White.

We'd now like to invite Commissioner Luis Aguilar to join us virtually from the Atlanta office. You can see him beamed up on the screen.

Commissioner Aguilar has served on the Commission since 2008. Prior to that time, he was a securities lawyer in private practice, where he specialized in securities, in corporate law, international transactions, investment companies, and investment advisors.

Commissioner Aguilar?

MR. AGUILAR: Thank you, Keith, and good morning.

Let me start by joining my colleagues in extending a warm welcome to the panel members and all other participants, including those viewing by web cast, to today's forum on small business capital formation. I very much look forward to your discussions.

As Chair White mentioned, there is absolutely no doubt that small businesses are the engine that drive the U.S. economy. The statistics bear it out.

The statistics show that small businesses make up 99.7 percent of all U.S. employer firms, 48.5 percent of the private sector employment, and 37 percent of high-tech employment. Small firms were responsible for 63 percent of the net new jobs created between 1993 and mid-2013, or more than 14 million of the nearly 23 million net new jobs created during that period.

There is no debate that the success of small businesses is essential to the sustained growth of our greater economy.

The SEC has long recognized the importance of small businesses.

For example, since 1979, the SEC has had the Office of Small Business Policy. In addition to organizing today's forum, and as Keith Higgins mentioned, this office is available to answer questions and, importantly, participate in rulemakings and other activities that affect smaller companies.

Moreover, in 2011, the Commission established an Advisory Committee on Small and Emerging Companies to provide the Commission with advice and recommendations specifically related to privately held small businesses and publicly traded companies with less than $250 million in public market cap. In fact, this committee is next scheduled to meet on December 17th.

And of course, the Commission has, over the years, promulgated a number of regulations that were geared towards smaller firms, some of which Chair White has mentioned, and this includes exemptions such as Regulation A that go back to 1936 and Regulation D, which has been very successful, that was adopted in 1982.

More recently, of course, following the passage of the Jumpstart Our Business Startups Act, better known as the JOBS Act, the SEC has focused on rulemakings intended to facilitate the ability of small businesses to access the capital markets. For example, just within the past 18 months, the Commission has pressed forward with a number of important initiatives in this area, including:

First, proposing rules on crowdfunding, which would exempt qualifying transactions from the registration and prospectus delivery requirements of the Securities Act.

Second, it has proposed amendments to Regulation A, known as Regulation A+, which would permit companies to raise up to $50 million in any 12-month period without requiring registration under the

Securities Act, provided certain requirements are met.

Third, it adopted final rules amending Rule 506 of Regulation D to remove the prohibition against general solicitation provided that all purchasers are accredited investors.

And lastly, among other things, it also proposed various rules to further amend Rule 506 to address concerns about the impact of general solicitation that were raised by numerous commenters.

In looking at the Commission's role in facilitating capital formation for small businesses, it is important to note that the Commission is to do so in a manner consistent with the protection of investors and maintaining the integrity of the capital markets.

It is obvious that a successful investment environment requires a system that works well for both issuers and investors.

The challenge, of course, is to develop a process that enables businesses to raise capital in a cost-effective way while also, importantly, providing for ways to benefit and protect investors and the markets generally.

As we all know, investments in companies, both small and large, inherently have risks. It is also understood, however, that investments in small or emerging businesses carry unique investment risks.

While it is hoped that many small businesses will grow and flourish and make money for both entrepreneurs and investors and benefit our economy, we should not lose sight of the heightened risks that these riskier enterprises pose for investors through the higher risks of small business failure, the lower liquidity of these securities, and regretfully, the higher incidence of outright fraud in the small business securities market.

Given these heightened risks, Congress and the Commission historically have sought to protect investors by requiring that certain conditions be met in exempt offerings geared toward small businesses.

Examples of this include but are certainly not limited to such things such as: limiting general solicitation and Rule 506 offerings to accredited investors that presumably are better situated to understand the risk of the investments and absorb any losses or imposing limits on capital that may be raised in offerings under Regulation A, as well as the limits that are to be imposed and the capital that can be raised under proposed Regulation A+ and the crowdfunding exemptions, and another example includes imposing individual and aggregate investment limits such as you'll see in the crowdfunding transactions. In addition, of course, many exemptions require that issuers make specific disclosures to the offerees.

I note that today the forum will consider one important issue that underpins the capital formation for small businesses, and that is the definition of “accredited investors.”

The forum's input on the accredited investor definition is particularly timely, because as Chair White mentioned, under the Dodd-Frank Act, the Commission is required to undertake a review of the definition as it applies to natural persons in order to determine whether it should be modified for the protection of investors, in the public interest, and in light of the economy.

Indeed, the Dodd-Frank Act mandates that the Commission commence this review no earlier than this past July 2014, and at least once every four years thereafter. So, we are in the midst of considering this definition.

In addition, the definition of “accredited investor” has taken on greater meaning now that issuers can engage, without registration, in unlimited advertising and solicitation, so long as the ultimate purchasers are accredited investors.

Given the importance of this definition in helping to identify investors that are presumably sophisticated and financially able to invest in illiquid securities, the accredited investor definition is particularly important.

Now, recently, as you may know, the Commission's Investor Advisory Committee provided the Commission with its own recommendations regarding possible ways to amend the accredited investor definition.

The IAC's recommendations would both limit and expand the pool of accredited investors, always with an eye to identifying individuals who should be able to fend for themselves.

In brief, the IAC has recommended that the Commission revise the accredited investor definition to enable individuals to qualify as accredited investors based on various ways of assessing their financial sophistication, such as through specialized work experience, through special investment experience, through licensing or other professional credentials, or perhaps even through a qualifying test developed by, or at least in collaboration with securities regulators.

The IAC, like many observers, however, is also concerned that the current definition of an “accredited investor” may assume too much. The criticism is that it is a crudely-designed method to distinguish between purchasers who are supposedly financially sophisticated and purchasers who are not.

Specifically, the definition assumes that individual accredited investors are knowledgeable and experienced about financial matters *if* they meet specific income or net worth thresholds.

Although one may argue that an individual with annual income of $200,000 or a net worth of $1 million is well off, those benchmarks do not necessarily correlate with a person's financial sophistication.

Indeed, the SEC's Division of Economic and Risk Analysis, better known as DERA, estimated that only a small percentage of U.S. households meeting the definition of accredited investor have substantial direct holdings of individual securities, which suggests that their experience investing in securities might be limited.

This point is important, because a general solicitation, combined with an offering exempted under Rule 506, means that the issuer is not required to provide information statements or disclosures to investors.

I know that the forum participants have a lot of experience and a lot to contribute to the definition of accredited investor, and I look forward to your discussions and your recommendations for a definition that works both for small businesses, as well as one that protects and benefits investors.

Now, I also understand that today's forum will feature a panel to discuss secondary market liquidity for the securities of small businesses.

This topic also has increased importance in light of new, and expected, Commission rules that would enable a far wider range of small business securities to be sold in the secondary trading markets.

For example, the larger dollar amounts of securities that could be issued under proposed Regulation A+ would not be restricted securities and therefore could be immediately traded by security holders who are not affiliates of the issuers.

Separately, as currently proposed, shares issued in a crowdfunding transaction would be freely tradable after a one-year holding period. Similarly, securities issued in private placements under Regulation D are permitted to be sold after only a one-year holding period.

Unlike large, well-established publicly-owned companies, one of the biggest problems long facing small companies is the lack of an actively-traded secondary market for their securities.

It is important that we look for ways to remedy that. One idea that has been suggested as a way to increase liquidity in small and mid-size companies is for the Commission to change the way shares are priced.

The idea is to widen the spread on small cap stocks so as to promote greater interest in these stocks and thereby promote greater interest in the small cap market itself.

To that end, and as Chair White has mentioned, the Commission is currently considering a 12-month tick size pilot program.

This pilot program proposes to study the effects of widening minimum quoting and trading increments -- that is, the tick sizes -- for certain stocks with smaller capitalizations.

As you may have read, this potential pilot program has already received significant criticism. For example, some commenters have suggested that an unintended consequence of increasing spreads could be an increase in trading cost for such trades.

Other commenters are concerned that the pilot program will benefit the national stock exchanges to the detriment of other alternate trading venues, such as dark pools.

Now, the comment period for the pilot program is still open, and I look forward to your thoughts on the pilot program either at today's forum or hopefully in a letter that you can send shortly, and I will also look forward to any other suggestions that you may have to address the anemic secondary market liquidity in a manner that works for companies, investors, and the markets.

Lastly, on an issue that's very important to me -- and I hope it is to you -- as you discuss the challenges facing small businesses, I also encourage you to consider the role that can be played by the brave men and women who have risked their lives to fight for our freedoms.

There is no doubt that veterans can help small companies grow. Veterans have long demonstrated through their commitment to service and their capacity for adapting to various environments and situations that they have the drive, experience, and skills to benefit any company smart enough and lucky enough to hire them.

I encourage small businesses to make a special effort to recruit veterans. It will benefit all of us. Without doubt, veterans are no strangers to the world of small businesses.

In fact, the statistics show that nearly 1 out of every 10 U.S. small businesses is owned and operated by veterans.

In closing, I want to join Chair White and Keith and Sebastian in thanking today's participants for being here today, and I also want to thank the hard work of the staff responsible for putting together today's forum. These forums are not easy to put together, and they've done an admirable and fantastic job.

I wish all of you a terrific and productive day, and I thank you for the time this morning.

MR. HIGGINS: Thank you, Commissioner Aguilar.

Next, I'd like to introduce Commissioner Dan Gallagher, who has served on the Commission since 2011. Prior to becoming a Commissioner, Commissioner Gallagher was a securities lawyer both here at the SEC, where he was the deputy director of the Division of Training and Markets, as well as in private practice.

Commissioner Gallagher?

MR. GALLAGHER: Thank you, Keith, for that introduction, and a special thank you to Sebastian for his hard work in organizing this conference, and quite frankly, for all of his amazing work generally. If only you knew what Sebastian did every day.

I see -- despite the klieg lights blinding me, I see Gerry Laporte sitting there in the audience.

It's good to see you, Gerry, and I can tell you that Sebastian is acquitting himself quite well. You should be proud.

In his role, Sebastian's role as chief of the Division of Corporation Finance's Office of Small Business Policy, he has probably the most important staff position at the SEC for promoting the capital formation needs of small businesses, which is, in turn, one of the most important things that this agency should be doing.

I was gratified to see that Corp. Fin. and Trading and Markets were able to work together on today's first panel regarding secondary market trading in securities of small businesses. Promoting the development of these secondary markets is incredibly important.

While a robust liquid secondary market has benefits of its own, it also promotes the health of the primary offering market, which directly benefits small business issuers.

I hope the discussion today will embrace the full scope of the public and private markets in small business securities.

As I've said before, I believe a fully robust capital markets ecosystem for small businesses requires both.

Specifically, there is a need for continued innovation in secondary trading in the private marketplace. If additional guidance from the SEC, for example, with respect to a private resale exemption, would help this market develop further, we should move forward on that and do it now.

I also hope and expect that we'll complete our Regulation A+ rulemaking mandated by the JOBS Act in the very near future. To fully activate the benefits of this new exemption, however, we need to consider how to create secondary markets in these shares.

I'm a strong proponent of an idea that this forum has floated in the past, venture exchanges, where Reg A shares can be listed and traded by anyone, not just accredited investors, and could do so with an exemption from state blue sky laws and with scaled listing standards appropriate for Reg A issuers.

I believe this could truly revolutionize small business capital formation.

Moreover, there's a longstanding need for better, more liquid markets for smaller post-IPO companies. We should consider better scaling of the periodic reporting regime for small companies to match commonly-accepted market definitions of “micro-cap” and “nano-cap.”

Venture exchanges or exchanges with similar scaled listing standards may help here, as well.

Companies barely clinging to a NASDAQ or New York Stock Exchange listing could fit more comfortably at a venture exchange, and companies currently trading OTC may be willing to up their game if the hurdle to become exchange-traded weren’t so insurmountable.

Finally, I wanted to touch briefly on the second panel today regarding changes to the accredited investor definition.

Frankly, I have yet to be persuaded that this is an issue that should be taking up our time.

Dodd-Frank's removal of the value of the primary residence for purposes of the net worth test has already been a significant change to the definition of accredited investor, but more fundamentally, I am baffled by continued insistence from some quarters that we need to significantly revise the accredited investor definition.

Why should we spend such precious Commission resources protecting the wealthiest 2 to 3 percent of investors in this country?

The obsession with protecting millionaires, potentially at the cost of hindering the wildly successful and critically important private markets, strains logic and reason. Millionaires can fend for themselves.

That additional government paternalism could also negatively impact the availability of capital for small companies is a double whammy, and rather than pressing our luck, we should be yelling, “stop,” and instead spend our time focusing on actually facilitating capital formation.

As I don't want to take anymore time away from what I hope will be a great discussion today, I'll conclude with a final thought.

This forum has advanced some really, truly excellent recommendations in the past, and I'm sure will continue to do so in the future. And yet there is at least a perception that these recommendations are not given their due.

So, I hope that, going forward, we can commit to respond to each forum recommendation in writing, as a way of validating that the proper attention has been paid to your voices.

If the Commission cannot make that commitment, at least this Commissioner will.

Thank you all for giving us your valuable time today, and I wish you a successful conference.

MR. HIGGINS: Thanks, Commissioner Gallagher.

(Applause.)

MR. GALLAGHER: Would you mind if I basked in this for just a minute or two? It's happened to me twice in three years, Keith. Thank you.

MR. HIGGINS: Commissioner Stein, I believe, has been unavoidably detained or delayed, but will join us a little bit later.

I'd like next then to introduce Commissioner Michael Piwowar, who has been on the Commission since August of 2013.

Prior to that time, he was Republican Chief Economist for the Senate Banking, Housing, and Urban Affairs Committee, working on both the Dodd-Frank Act and the JOBS Act.

In addition, he served in the White House as a Senior Economist on the Council of Economic Advisors.

Mr. Piwowar?

MR. PIWOWAR: Thank you, Keith.

By applauding for Commissioner Gallagher, you have no idea what you've done. We're going to have to deal with his big head for at least three years, I think it's going to last. So, we'll see.

No, seriously, thank you, Keith, for that introduction. A special thank-you to each of the audience participants here for giving up your time and spending your money to join us here in Washington, DC. It's so important to hear your voices.

Perhaps in the future we might consider alternating the venue of this forum with locations elsewhere in the country, so that we can make it as broadly accessible as possible.

As my fellow Commissioners have mentioned, it's no secret that small businesses are the engines that power our economy. They foster innovation and offer opportunity for millions of Americans.

These small corporations and businesses are crucial to increasing prosperity and creating jobs, but without adequate access to capital, a small business might never get out of the starting gate.

As a former staff member of the U.S. Senate, as Keith mentioned, I saw firsthand the concerns about small business capital formation.

One of the signature pieces of bipartisan legislation accomplished during my time with the Senate was the passage of the Jump Start Our Business Startups Act, better known as the JOBS Act. Indeed, a signed copy of the JOBS Act hangs on my office wall here at the Commission.

I'm very happy to be part of the 33rd Annual Forum on Small Business Capital Formation today. The statutory purpose of this forum is to review the current status of problems and programs relating to small business capital formation.

So, I'm pleased to see that representatives from other regulators, from the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Small Business Administration, FINRA, and state and provincial securities regulators -- here today alongside our Commission staff.

I'm keeping my remarks short today, because I want to use this forum as an opportunity to listen and learn. I look forward to today's discussions, as well as the recommendations that will be forthcoming.

Those recommendations are reviewed by many people, including members of Congress and their staff.

In fact, when I have conversations about small business with my former colleagues on Capitol Hill, including conversations about so-called “JOBS Act 2.0” bills, one of the first documents they reference are the reports from this forum.

Thank you again for your attendance today. I'd also like to join Sebastian, Keith, and my fellow Commissioners in thanking our staff for their dedicated work in organizing this forum.

Thanks.

MR. HIGGINS: Thanks, Commissioner Piwowar.

Now I'd like to pull an exit stage left and turn over the microphone and my seat to Steve Luparello, who is going to introduce the first panel. Steve is the director of our Division of Trading and Markets. He came to the Commission from Wilmer Hale and, before that time, had a 16-year career at FINRA, where he was most recently a Vice Chairman and responsible for, among other things, FINRA's examination, enforcement, and market regulation programs.

He also played a key role in the creation of FINRA's Office of the Whistleblower and the Office of Fraud, Detection, and Market Intelligence.

So, I'm going to put the tent card up for Steve and turn it over to him.

Steve.

Panel Discussion: Secondary Market Liquidity for Securities of Small Businesses

MR. LUPARELLO: Keith, thank you for the introduction, and thank you for the disclaimer. I think, when you said the ideas may not even be ours, I thought you were going to say, at least for me, the ideas may not even make sense.

So, the fact that you -- you modified it a little bit, I do appreciate.

So, I'm going to quickly turn it over to Stanley Keller, who is a partner at the Boston office of Edwards, Wildman, Palmer and has extensive experience in this space. He is going to talk about it from a Securities Act standpoint. I'll try to chime in from a '34 Act standpoint. Obviously, liquidity has -- liquidity issues are important in this space and have both '33 Act and '34 Act components.

It's nice for me, actually, to be somebody asking the provocative questions, as opposed to being provoked, which is what I usually am in this space.

So, with that, I'm going to quickly turn it over to Stanley.

MR. KELLER: Thank you, Steve.

I am delighted to be here. One reason is because I was here at the creation.

I was on - I was the American Bar Association representative at the -- on the Planning Committee for the very first Government Small Business Capital Formation Forum, and stayed with it for a number of years, and this forum has had a really significant impact on the development of securities regulation when you look back.

We have an ideal panel, I think, to deal with the issues of secondary market liquidity, and while I've been sitting up here patiently all this time, let me now introduce who has been here, and let's see, I'll try to get this in the right order.

To my right is Vladimir Ivanov, a Senior Economist in the Division of Economic and Risk Analysis, otherwise known by shorthand these days as DERA, and prior to being with the Commission, Vladimir was in the academic world as a professor of finance.

I'm looking to see who's there.

Mike Zuppone is next, a partner at Paul Hastings in their New York office specializing in securities and capital markets, and in a prior life, Mike was with the SEC's New York Regional Office.

Next is Robert Malin, the Vice President of sales of the NASDAQ Private Market, which, as you know, is a resale platform venture of NASDAQ and SharePost, if I'm right.

And then next -- next to Robert is Cromwell Coulson, CEO of OTC Markets Group, and again, as you know, the prominent market for unlisted securities, which we have fondly known for years as the Pink Sheets. And it's interesting to see what's been done and what's happened with that market.

And then, finally, and certainly not least, as you'll hear throughout this morning, is Heath Abshure, who is the Securities Commissioner of the State of Arkansas, past President of NASAA, and so in a position to give us the perspectives from the state securities administrators and state securities regulation.

What I'm going to try to do is maybe quickly provide some context by giving an overview of some of the issues, and I'm going to refer to something Keith said.

The views I express may or may not be my own, and one of the privileges of moderating is you can take different positions, even one after another, for the purpose of provoking discussion and - conversation -- but you may find some of my own views slipping in from time to time.

I think we've already heard some references to the importance of secondary market liquidity, and I think it is important to kind of bear those in mind.

Indeed, secondary market liquidity is critical for the promotion of capital formation. It's through the opportunity to have exits that you get people to invest, and put their funds at risk in the first place.

A key question is, what is my exit strategy and how long a time do I have to wait? And we all know all of that goes into the, if you will, rate of return on investment.

Second, and related to that, the secondary market liquidity also permits the redeployment of capital. So, it has a broader value and benefit to economic growth in general.

We know that a lot of the equity that's out there has been awarded to employees as, if you will, value compensation incentives, a means for smaller companies to preserve their capital by using, if you will, their paper in place of -- in place of their funds.

And market liquidity is important to give those employees, really, the pot at the end of the rainbow or the liquidity along the way, to fulfill the promise that that equity provides.

And at least finally on the list that I put together, market liquidity also serves as a safety valve, if you will, for companies to relieve the pressure that they feel from investors to achieve an exit strategy. And what that does is give companies, if you will, greater control over their own future, more time to build and grow before that pressure mounts so highly that they need to look for the sellout strategy, if you will, to achieve that liquidity, and we've all seen that happening in practice.

Now, what is the current regulatory structure? As Steve said, there are really two key aspects to that -- the Securities Act side and the Securities Exchange Act side, which covers the trading and markets aspects.

You know, some basics to bring everybody up to speed.

On the Securities Act side, we all know the fundamental principle: all offerings must be either registered or exempt. I think I learned that my first day in securities regulation in law school, and that's true of re-sales.

You have to find an exemption or else there needs to be a registration.

The key factor in applying this is the differentiation that's made between primary offerings and secondary sales. There are different layers, different measures, if you will, for the exemption, depending upon what kind of offering you're dealing with, and indeed, that raises questions that we've seen from our friends in the Division of Corporation Finance.

When is a secondary offering really a primary offering in disguise? Not a problem that a lot of us have dealt with.

And as a statutory matter, when can that secondary offering be treated the same as the primary offering when viewed from the perspective of the ability to have those shares registered and, if you will, have the benefits of registration, which leads to the next difference to keep in mind, which is the difference between re-sales by affiliates or controlling persons and non-affiliate re-sales, different measures, different tests, different requirements.

And then, finally, we live in a world where there's a difference between restricted and unrestricted securities, so trying to keep all of those in mind as we go through the alternatives and how changes may be made.

The alternatives we deal with, as you know, are the basic resale exemption, Section 4(a)(1), which I think is fundamental in the Securities Act, combined with the Section 4(a)(4) broker exemption.

That's for public market re-sales, typically by non-affiliates, to be able to freely trade in -- in the marketplace.

But that's not always applicable, and we have the analog to the private offering exemption and what's been known as 4(1 1/2).

Now, there are some purists who want to re-label that 4(a)(1 1/2), because Congress added a 4(a), but since there's no 4(1 1/2), I think it's fair that we can stick to calling it 4(1 1/2), and that's simpler than trying to master 4(a)(1 1/2), and indeed 4(1 1/2) is a construct, in a way, almost of the private market, and what we have proposed in JOBS Act 2.0 is a statutory codification and perhaps expansion of the 4(1 1/2) exemption in a proposed Section 4(a)(7), which will be worth talking about.

The SEC gave us certainty under, if you will, Section 4(1) with Rule 144. And you've heard about the restricted period, when you're dealing with restricted securities, the way in which control persons, affiliates, can dribble out shares to the market, where it's not a distribution, and of course, let's not forget the registered secondary offerings, which play an important role in the marketplace. And on top of all of this -- and we'll hear more about this, certainly, from Heath -- the state securities laws overlay.

Now, on the market regulation side -- and I really should turn this back to Steve, but he'll correct me, cause I don't play in that game as much, what we've seen is the emergence of secondary market trading platforms, and the question is: What is their status? What is their role? We've seen some that were registered broker/dealers, some that were alternative trading systems, indeed some that were just platforms, and how they are regulated is an important part of, if you will, increasing access, their ability to provide access to the market and provide liquidity.

When we talk about these trading platforms, one of the key questions -- and I think Commissioner Gallagher mentioned it -- is the availability of the information.

To what extent is there transparency that gives us confidence in those trading platforms in the markets in which investors will be participating? And we'll hear more about that.

There are a number of challenges for smaller companies, I think, that have arisen as a result of the JOBS Act change in the Section 12(g) registration threshold. I'm going to come back to this later in our panel discussion if there's more time.

But I think having in mind that, unlike the forum a couple of years ago, where we were dealing with a threshold, a limit, if you will, of 500 holders of record, before a company had to enter the SEC registration and reporting system, we now face the prospect of larger companies with larger, broader, more diffuse shareholder bases, before they enter into the regulated registration system. They can stay unlisted. They can manage their affairs so they're unregistered. And how do we deal with those companies, both looking at it from a regulatory perspective, from a company perspective, and if you will, from the obligations of companies to their investors. And as I said, perhaps more on that later.

Let me finish with just trying to tee up some things for discussion as we go along.

What are some of the regulatory challenges? Balancing increased liquidity with the protection of investors and of the trading markets, not just the individual investors but, more broadly, those who are looking to participate in those markets and to have confidence in those markets.

How do we distinguish trading from distributions, especially when it involves affiliates?

How do we deal with, now, the increased number of companies where there may be an absence of an information regime that provides that information to the marketplace? And related to that, is the dichotomy between exchange-listed and non-exchange-listed trading activities and the, if you will, regulation that comes from listing on exchanges.

How do we deal with the absence of pricing information and transparency of pricing in a marketplace that may not be a regulated marketplace for companies with a broader base of shareholders? And finally -- and it's not on the slide -- what's the role of the states in dealing with the integrity of secondary market trading and liquidity?

So, with that, Steve, do you want to add anything?

MR. LUPARELLO: No, I think that sets the table nicely, and I think you referenced quickly the '34 Act components, and you know, we in Trading and Markets bring the assumption that, when you're born, you're born as a broker/dealer and you have to prove yourself otherwise, and one of the few ways to do that is by proving yourself as an exchange.

So, that's always a helpful construct, especially with this panel, but we try to be flexible when we need to be, and with that unhelpful comment, I'll turn it over to Vladimir.

MR. IVANOV: Thank you, Steve, and welcome everybody.

I'm going to shift gears a little bit and talk about the primary market for unregistered offerings. I'll try to show you how large and active it is, how many investors participate in it, and talk about some of the implications for the secondary market of these offerings, and I'll talk about one of the most popular exemptions, Regulation D.

First, to give you an idea of how large the Reg D market is in terms of both dollar size and relative to other markets, the first graph that I have shows the amounts raised in this market from 2009 until 2013.

As you can see, it's a market that raises about $900 billion per year. It dwarfs the market for registered equity securities.

Reg D offerings -- 65 percent of them are equity-type holdings, similar in comparison to the market for registered debt offerings, and larger than the Rule 144A market.

The numbers that we have actually underestimate the amounts of capital raised through Reg D offerings, because we cannot capture issuers that do not file Form D. We get all this information we use from Form D.

Also, for those of you who have followed our Reg D study, 99 percent of this amount is raised using Rule 506.

Who are the issuers in this market? Well, in terms of amount of capital raised, about 75 percent of the funds raised are raised by pooled investment vehicles: hedge funds, private equity funds, other investment funds.

Operating companies, which we note are non-financial issuers, also raise a sizeable amount of money. For the past five years, they have raised about $400 billion.

And although half of these operating companies declined to disclose their size when they filed their Form D, for those of them who disclose, the wide majority –of these are small companies. And by small, I mean with less than $5 million of revenue.

If you look at the number of offerings, by far the operating companies dominate the market. They raise five times more offerings than, for example, hedge funds.

So, the average issuer in this market is an operating company, small one, raises up to a million, million-and-a-half per offering. That's the median size. For hedge funds, for example, the median size of their offering is about $100 million.

How about the investors in this market? So, for the five years of data that we have, on average, there's about 230,000 investors in Reg D offerings annually, and the majority of them invest in Reg D offerings by operating companies, about 96,000.

The other interesting piece of information from this table is in the last two columns. It's the split between accredited and non-accredited investors. As you know, most of the Reg D exemptions allow for a certain number of non-accredited investors.

Well, the information that we have shows that about one in every 10 Reg D offerings has non-accredited investors, and usually it's one or two investors. The average is one non-accredited investor.

So, annually, there are about 1,100 non-accredited investors participating in Reg D offerings. Most of them invest in offerings by operating companies. That would change with the adoption of the regulation on crowdfunding.

It's been a year since we adopted Rule 506(c), which allows for general solicitation and sales only to accredited investors. What do we observe from this one year? Well, the amount raised by 506(c) offerings, very small, tiny, so far, compared to the amount raised in 506(b) offerings.

We are talking about $25 billion raised in 506(c) offerings in the last year versus almost a trillion dollars raised in 506(b) offerings, and on average, the 506(c) offerings, which include only accredited investors, have fewer investors compared to the 506(b) offerings.

What is interesting about the 506(c) market is that, actually, the majority of capital raised is raised by operating companies. As I mentioned earlier, in the 506(b) market, pooled investment funds raise about 75 percent of the capital.

Here in the 506(c) market, operating companies raise about 55 percent of the capital, and again, it's just one year of data, so difficult to draw any strong, you know, inferences, but that's what the data show so far.

Lastly, how do the current Reg D offerings fit within the offering limits set in the pending JOBS Act regulations like crowdfunding and the new Reg A?

As you can see, about 90 percent of Reg D offerings are for amounts less than $50 million. So, about 90 percent of those would fit the new Reg A limits.

About a third of currently raised Reg D offerings are for amounts less than a million. So, they would fall under the crowdfunding limit.

So, I've thrown a lot of numbers at you for these five minutes.

To recap, the market for private offerings is a large and very active one, okay, with about a quarter-of-a-million investors investing every year, likely to get larger with the passing of the crowdfunding and new Reg A. Obviously, that would spur demand for liquidity and would affect the secondary market.

Crowdfunding likely -- we don't know, but likely -- would change the mix of investors that come to this market. It's likely that more less sophisticated investors will participate in private offerings, which again would have an impact on the secondary market for these offerings, and also, one of the big benefits of the new Reg A is the ability to trade shares right away, for investors to get liquid shares.

Obviously, the presence of an active liquid secondary market would be paramount for the success of the new Reg A rule.

And with that, I will turn it over to Michael.

MR. KELLER: Before you do, just maybe clarify one thing.

I take it these statistics are based upon the filings that have been made, and there is a whole world out there that isn't reflected in those filings, not only because people aren't complying with the requirement to file Form D, but there is something called the statutory --

MR. IVANOV: Yes.

MR. KELLER: -- exemption.

MR. IVANOV: Exactly. So, we don't -- we cannot capture issuers that rely on the Section 4(a)(2) exemption. We don't know how big this market is. We have just very limited information.

Besides Reg D and Rule 144(a), a market which is mostly debt securities, we don't know anything about other unregistered offerings that use other exemptions. So, the likelihood is that, in its, you know, completeness, the private offering market is very large, much larger than the, you know, $900 billion, on average, that we see for the Reg D.

MR. KELLER: Thank you.

MR. ZUPPONE: Thank you, Stanley.

I think Vladimir's comments, his last comments about the success of Regulation A+ turning on overcoming the re-sale trading market liquidity challenges is a great segue into my comments and remarks.

I want to thank the Commission and its staff for putting this very important topic on the forum's agenda, because I do think re-sale trading liquidity is critical as you think through a lot of what's been implemented thus far in the JOBS Act and hopefully will be implemented as the Regulation A+ rules are adopted.

I am not going to focus, like the other panelists, on the private company re-sale trading but focus on companies that enter the market in traditional public offerings, and hopefully soon, pursuant to the new Regulation A+ offering exemption, as revitalized by the JOBS Act.

I promise you I did not consult with Chair White before I put the slide together and put the word "challenges" in there. She referred earlier to liquidity challenges being critical to the success of the new offering regime.

I think it's fair to say that a lot of commentators have, previously, in forums in the past, and elsewhere, commented on the challenges confronting small cap companies in the trading market.

There is a solution, and in fact, I am working with a client that's hopefully going to develop a solution to create a more hospitable trading market for small cap companies.

I think the catalyst for that will be the change in SEC regulatory policy. I think, as signaled by Commissioner Gallagher's remarks, the Commission appears to be open to hearing what the market has to say.

And then obviously the beneficiaries of any change in policy will be the small companies that will drive job growth, presumably, as they raise capital, grow capital, and employ more of the unemployed.

So, the challenges confronting small cap companies in the trading market -- it's my word to call the trading market inhospitable.

Whether it's high-frequency trading as the problem -- you know, we've all read -- or some of us have read -- the Flash Boys -- and certainly a market dynamic that doesn't seem very welcoming to smaller companies.

The other issue that confronts -- and many have commented on this -- and in fact, the tick size pilot is intended to address -- is decimalization.

I think that pilot will prove out what I think a lot of observers have concluded in their previous recommendations to the Commission that tick size counts, to bring economics back into the trading in small cap companies, but what has been less paid attention to is the stock exchange economics in this, traditional stock exchanges. If you parse through the 10-K and 10-Q filings and you look through some of the public commentary that's out there in news reports and you do some simple deduction, you can conclude that the amount of revenue that is earned from trading in small cap companies is miniscule.

I was trying to tie it out with some actual data points but did not have enough time to provide a source. But anecdotally, it's been reported to me that it is as low as 2 percent of the revenues of these for-profit companies that are now running these stock exchanges account for trading in small cap companies.

And so, from my vantage point, since the economics would suggest that there's just simply no incentive for those market actors to develop a solution, there will be new entrants into the marketplace that hopefully will provide the solution.

One of the choices, as new actors come into the market and develop some alternative for Regulation A companies, for example, to trade in the after-market, is whether you do that as a registered stock exchange or as an alternative trading system.

I think it will be incumbent on the Commission and its staff to think through its own policy choices and its own policy concerns about whether that kind of trading will take place on stock exchanges or alternative trading systems. I think there will be a need, ultimately, for some policy accommodation to foster that marketplace.

In effect, it will require a rethinking, I think, entirely of a lot of the regulation of the market system today.

Not to pick on Regulation NMS -- it shouldn't be a focal point of this forum, but it's my view -- and I think it's the view of others -- that, you know, the dictates in Regulation NMS are not necessary to produce, I think, what are the policy goals of fair, efficient markets.

There are alternatives, and hopefully, as the Commission thinks this through, it will be open to viewpoints and potentially policy accommodations around those viewpoints that produce an alternative where companies can trade outside of the NMS environment.

MR. GALLAGHER: Amen.

MR. LUPARELLO: You beat me to it.

What is the wish list? NMS is a large basket. People can find a variety of things to like and dislike inside that basket, or just dislike the whole basket in its entirety.

When we look at coming to different structures, and I think, as the Commissioner has pointed out, and the Chair, others in a variety of different fora, I think we are open to the notion that one size should not fit all for market structure, especially in the equity space.

Is there a specific wish list, or is there just a desire for the staff to demonstrate an openness to structuring markets around different characteristics, as opposed to having a monolithic approach?

MR. ZUPPONE: I don't have a wish list today, but I do have some thoughts that the openness would be well received.

There are some actors out there in the marketplace, I think, that would welcome the opportunity to consult with the staff on their thinking and what solutions they can design that would potentially be out of the NMS system but nevertheless address the fundamental policy goal, which is to have a fair and orderly market.

MR. GALLAGHER: Are you inviting wish lists on this issue?

MR. LUPARELLO: You already know where my office is.

MR. GALLAGHER: I think you already have my wish list on this, but you know, just to echo the point, just at a high level, to the extent that Reg NMS has homogenized the exchange trading of equity securities in the United States, which it has -- all right -- it's basically made every exchange a utility.

It's taken away the ability to trade idiosyncratically. It has demanded, effectively, high-frequency trading and all of these other things that are anathema to secondary trading in otherwise illiquid small business securities. And so, we need to address that, and one size doesn't fit all, and if it means we need to have non-NMS venture exchanges, non-UTB, wholly idiosyncratic standalone ecosystems for secondary market trading where you can trade continuously or by auction or, however, you want to do it, that's what we need to do. We need to be creative in this space.

MR. LUPARELLO: I think that's exactly right, that we have to be open to a variety of different structures, and the extent to which we create roadblocks to that flexibility, those should be pointed out and we should -- we should work on them, all the time, obviously, making sure that there is sort of that floor of investor protection and orderliness to the market, and the extent to which that does add a little bit of homogeneity, which, you know, under-girds the flexibility, I think we want to try to strike that balance, but getting that balance right can be difficult.

MR. PIWOWAR: Amen. I think we should encourage as much experimentation as possible.

Some people have suggested that -- we move to a model where issuers could be allowed to hire for contract their own designated market makers. I think that might be something that might be worth looking into in this particular market.

But this idea that one size fits all -- we know it doesn't fit all, and we know there's something wrong with it, and we need to just continue to try to experiment, and whatever we need to do to get out of the way, folks need to let us know what it is.

Is it a rule standing in the way? Is it a FINRA rule? Is it Reg NMS? Whatever it is that we can get out of the way, we need to know.

Thanks.

MR. LUPARELLO: Mike, we're sorry we hijacked it.

MR. ZUPPONE: No, that's fine. I think this is exactly what this forum is intended to accomplish.

So, a couple of thoughts on the next slide. I think one of the challenges to creating a new market is, if you build it, will they come, and you know, there's a natural, I think, demand coming out of potentially the new companies that are going to do their IPOs under the new Regulation A and then thereafter report in a reduced disclosure environment if there is a trading market that is a natural fit for them that would be a logical home for their listing, but that will be slow in the making, and so, one other additional thought the Commission can think about, in my mind, is let's just assume that you have OTC companies, listed companies that are an identical twin -- maybe it's triplets.

You have one trading in the OTC market, one trading in the listed market, and the other trading in the new Regulation A market.

You know, why should identical twins that have the same industry, the same businesses, same economic profiles have varying reporting obligations once they're out there in the trading market, and my thought process is that, if there is a way to measure those companies that became public before the adoption of these rules, create a rule that allows them to migrate into the new Regulation A reporting system, whether they be listed on a stock exchange or trading in the over-the-counter market.

There are literally thousands of companies that would fit that bill, and that mass migration could readily populate a new trading market that would be viewed potentially as more hospitable to those companies in the marketplace.

MR. KELLER: Mike, can that be viewed as creating more of a layered periodic reporting system, that certain companies would be subject -- and let's just take an example of semiannual reporting rather than quarterly reporting, and it's -- so that there is that differentiation, that that's not so much tied to the exchange but rather to the, if you will, size and breadth of the trading market in that particular company?

MR. ZUPPONE: I think that's part of the discussion. Certainly if you were to ask for my legal advice, I would advocate for some form of quarterly reporting even if you are not required to report.

As you know, foreign private issuers report on a semiannual basis, and virtually all of them, at least the ones that I've been associated with over the years, report quarterly, and that information is available to the marketplace, and I think that's the paradigm for smaller companies, but right-sized reporting obviously being the key.

I don't want to make this a discussion solely centered on the blue sky ramifications of --

MR. ABSHURE: I see a bad word on this slide.

MR. ZUPPONE: Well, what I -- I think if you're going to have a trading market -- and I know the Commission has not made its policy choice yet.

We have yet to see the final Regulation A+ rules, but on the premise that there is going to be some blue sky preemption, I think you have to logically follow it through so you don't have frictions in the trading market.

It has to be consistent treatment for both the primary market and the secondary market, and that is obviously a policy choice that has yet to be made by the Commission and will be made soon.

MR. ABSHURE: If we can stop here for just a second. I want to make sure that everyone understands. The states aren't interested in standing in the way of capital formation by small business. However, the states are opposed to attempts to facilitate liquidity in an uninformed, opaque market.

This gives rise to insider trading, market manipulation, as we've seen these types of things before.

If you look at kind of the premise of re-sales that are treated as covered securities now, you see a couple of things that tend to pop up.

One is '34 Act filing status, which I'm not proposing is necessarily what we need for Reg A securities, but you certainly need a disclosure regime. You need some way for the information to get there to actually establish the pricing in the market.

The other thing that was there that I don't know if it's going to be here is the substantial analyst coverage that you have in the existing markets, in the existing exchanges, and the oversight provided by those exchanges.

State securities examiners already have a number of exemptions that would apply to Reg A securities that look a lot like 4(a)(1), the 4(1 1/2) implied exemption -- although I will point out the states' -- ours -- is actually in the rules-- and 144 -- we have an isolated non-issuer exemption. We have an affiliated exemption.

A lot of states have exemptions to tie in with Rule 144, and we also have a manual exemption, which, as you all know, is based upon the provision of information about the issuer.

I think it's rather premature to propose preemption at the state level when you don't have, really, an idea of what that disclosure or that periodic reporting regime is going to look like. Because the fact is, if that periodic reporting regime is sufficient, the states are inevitably going to develop a uniform exemption model for the re-sales.

So, that's, I guess, my first point.

The second point, regarding the proposed definition of “qualified purchaser” to include any purchaser offered and sold pursuant to 4(a)(1) or (3), we've objected to this on a number of different occasions upon the basis that you're attempting to define qualified purchaser without any reference to the purchaser's qualifications.

That's like saying you're a qualified surgeon if you can pick up a knife. I think the qualified purchaser has to get back to what's clearly implied by the statutory language, that this is someone that -- the purchaser him or herself -- actually has specific qualifications.

So, just defining that by reference to the actual offering that they're participating in, we would -- we would object to that, as well.

MR. KELLER: Heath, isn't this point, at least as I read it, really going to the quality of the information that's available. And so, it's taking the exchange listing exemption, indeed the manual exemption if you want to get historic about it, and saying, shouldn't Regulation A+, as proposed, with continuous reporting obligations, be treated similarly for purposes of re-sale. And I'm distinguishing here between the primary offering preemption and re-sale.

It's really, as I get your point, Mike -- and tell me if that's right or not -- really seeking to equate the information that's available because of the reporting obligation in the Reg A+ context with what's now accepted for the exchange listed. And Cromwell, I'm sure you want to comment.

MR. COULSON: So, we have got a lot of experience with blue sky, and we started out very naïve, thinking, well, we can go into the states and get the manual exemption, then we can go to the other states that require a filing.

So, here's the reality of secondary trading -- and this is statistics for companies, our OTC QX marketplace -- that you can't be a penny stock to qualify.

We built the financial standards on the Uniform State Securities Act. So, we thought we would be okay -- and in 80 percent of the states -- Heith's state is a great one

-- they have a great blue sky law. It's awesome. It works.

There's the manual exemption. I could debate the manual exemption. Nobody uses that for investment information anymore. There's this thing called the internet that people go to instead of the local library.

But that piece of the idea works. It needs to be updated.

Ten percent of the states you've got to go do some work to get in there, and like you've got to do these filings, notice filings.

The other 10 percent, it's impossible. You cannot become blue sky, whether you are Roche's ADR, you are an SEC-reporting company, you're a billion-and-a-half-dollar community bank holding company. You cannot become blue sky in the United States in every jurisdiction.

So, that comes across to something more important: the commerce clause.

Trading through broker/dealers in secondary markets is interstate. It’s interstate activity, and we should facilitate it, because I would love to be able to walk into NASAA and say we're talking to them and we're going to try and inch our way to get that -- that 90 percent to 92 percent. But the TSX, in 2002, they did a NASAA standard form exemption for the Toronto Stock Exchange, not their venture market, the Toronto Stock Exchange, went through NASAA, big announcements.

How many states have done that? And that's the problem. I mean, I don't -- I think the states' intentions are incredible. They do a great job policing broker/dealer sales practices.

So, we should really just say let's make sales through broker/dealers, anybody be a qualified purchaser if you buy it through a broker/dealer and there's adequate current information, and then let's also make sure -- let's not leave the states out.

Let's make sure that FINRA is giving data to the states of what securities are being sold by broker/dealers in those states, so we can use the regulators there -- I watch the state regulators.

They're incredible at policing bad sales practices by broker/dealers, and how could we have the right regulator at the right spot. Rather than -- you know, I got married in Italy.

You had to get 10 different stamps to get married in Venice, and I can tell you, after the third stamp, we were done, we'd done everything, and the idea that you have to go through all these places. With Reg A, after the SEC has reviewed a disclosure statement, you now have to go to all these states. So, this is something which is -- we need to have a national system for brokers to be able to trade securities.

There is no broker/dealer I know that is only an intrastate broker/dealer.

Their servers are somewhere else. Their compliance team is somewhere else. Their regulator is somewhere else. They're incorporated somewhere else.

This is a Commerce Clause piece. We need to address it, or Congress should.

MR. ABSHURE: I will have a response to that, even though this is a re-sale panel.

NASAA has developed a coordinated review program for Reg A, Reg A+ offerings.

In fact, we just had our first issuer go through, and he submitted a letter to Chair White -- unfortunately, it was only on November 18th. I don't know how many of you have had a chance to see it. I've highlighted a few of the relevant portions.

"We strongly disagree with the proposal to preempt state registration."

Now, this is not our letter, this is the issuer's letter, and -- and they make a number of different observations here.

"The coordinated review process is

communicative, user-friendly, and easily manageable. Defined services standards provide certainty, save time and save money. Coordinated review states are able to provide more direction in addressing comments. NASAA statements of policy were applied in a uniform manner and well explained.”

My point is that, at least for an initial offering, NASAA has taken the step to provide a uniform review for that offering. And I think that -- honestly, I think we're ahead of the SEC there.

Now we're looking to re-sales, and I guess the point I have is, we already have a number of different exemptions there that might work, but whenever we see what the information requirements are, what the periodic reporting requirements are -- and like I said before -- I'm not saying those have to be '34 Act requirements, but there has to be a disclosure regime there.

There has to be some sort of information to establish a trading market, or we're just trading on the basis of volume. And I think once that happens, the states will move very quickly to adopt a uniform exemption to cover the re-sales of those securities, but I don't think you preempt us until you give us a -- you're proposing preemption before you even have the information requirements there, and that doesn't seem to make sense to me.

MR. ZUPPONE: So why is the Toronto Stock Exchange not recognized?

MR. ABSHURE: Because they're Canadian.

MR. ZUPPONE: Well, now we have it.

MR. ABSHURE: When you say it's "not recognized," what do you mean?

MR. ZUPPONE: So, we have lots of TSX-listed issuers that are traded on our OTC QX marketplace -- Bombardier, Canadian Oil Sands. You've heard of a few.

They can't get blue sky compliance in every state, and this is after NASAA has done it for the Toronto Stock Exchange, and this is, you know, 12 years ago. So, we're -- I mean -- and they can -- we can get it in Arkansas, so -- and the problem is -- I would love to be able to work with NASAA.

We'll do anything we can to have our standards for our higher marketplaces aligned with NASAA's blue sky's needs.

We will do whatever you believe -- if you think we should go with the old Pacific Stock Exchange standards -- whatever you need -- to give a path for Bombardier to get compliance across all states, because we’re blue sky. What people don't understand about blue sky is there are three reasons it matters.

It doesn't matter for the self-directed investor coming through a broker that gives no advice.

Number one, blue sky limits brokers giving advice on securities. So, you lose that whole skill of the financial services industry to say, hey, don't buy it; hey, maybe that's a little too -- more risky. And you send brokers -- you send investors to the non-advice securities.

Number two, brokers can't distribute research to retail investors unless something is blue sky-compliant in every jurisdiction. We see that.

And number three, brokers that do give advice won't even take unsolicited orders, because they're worried that the investor will come back later and say, actually, the broker recommended it to me on the side and there's rescission risk, so you've got to cancel the trade, and they only do that if the stock's gone down.

So, we've created this process -- and I would love to be able to go through with NASAA -- and we're open to working with whatever standards you'd like to see, to say here's a standard, meet it, and we'll make sure that it's more real time than the manual, and they'll also be in the manuals as a belt and suspenders, but this doesn't work, and it is stopping interstate commerce, and it needs to be fixed, and let's, you know --

MR. ABSHURE: I just want to make sure that I understand your objection.

Now, the three points you just made -- I disagree with all three of them.

MR. KELLER: We'll come back to this, but really, to make sure everybody kind of gets a chance to lay some issues out on the table, let's go back to the order we had tentatively agreed on, and again, I think now we're focusing on trading in public or what I like to now call quasi-public shares, because what's public and what's not is now getting -- the line isn't as clear as it used to be.

Mike, do you have any more points you want to wrap up, because you've been jumped on your slides.

MR. ZUPPONE: Well, I don't think I was jumped on. I think I was initiating a debate that is actually welcome to get to the right solution. I think we have to hear all viewpoints. So, I have concluded my remarks and happy to continue participating in the debate.

MR. KELLER: Let's give Robert a chance to give his perspective, which may focus somewhat more on the not-yet-public or quasi-public company.

MR. MALIN: Thank you, Stanley. Also, thanks to the SEC and particularly the organizers of the forum.

I'm delighted to be here and give our views.

As a practitioner in the private share space, I'll confine my comments to private company trading.

Not all those companies, I would say, qualify as small businesses, many are quite large, but where to begin is usually the challenge when we're talking about the private shares trading.

But I think what might make sense for me and for NASDAQ Private Market is to give a little bit of the history and evolution of some of these private share trading platforms going back only to the recent past when NASDAQ began to evaluate the private share market for their entry into that marketplace.

And so, that evaluation commenced with a recognition on NASDAQ's part that, with changes in the JOBS Act, specifically the increase from 500 to 2,000 of shareholders before required registration, as well as what Michael called the inhospitability of public markets for growing private companies, in some cases, that there was the likelihood that more and more private companies would remain private longer or remain private indefinitely.

And so, with that recognition, NASDAQ saw an opportunity to create the NASDAQ private market to bring some standardization, some greater efficiency to the private shares market, and so, with that as a background, I'll give a little bit of at least my view of the history of some of these private market platforms.

So, the NASDAQ Private Market was created via a joint venture between NASDAQ and SharesPost in March of 2013. NASDAQ itself began its evaluation of the private shares market probably about halfway through 2012.

So, prior to the establishment of the NASDAQ Private Market in early 2013, what had existed in the space were principally platforms designed for the benefit of private share buyers and sellers, and the benefit they were promising those market participants was essentially more efficient mechanisms for the identification of counter-parties to a proposed transaction.

So, SecondMarket and SharesPost, most notably, would display on their websites offers and bids for private shares posted by employees, ex-employees, other shareholders, and what that allowed those participants to do is identify the other side of the trade. But once identified, those platforms also sought to ease the efficiency with which the host transactions could be closed, completed, and settled. Additionally, there was -- those platforms served the purpose of accrediting the investors, so identifying the buyer of those shares as an accredited investor.

The shortcoming in those platforms, quite frankly, was that they left any service to the issuer companies, and when I personally and when NASDAQ Private Market began to engage private companies in early 2013 and asked them what their concerns about this marketplace were, most considered these platforms to be, at least in some ways, antagonistic in that that public posting of a sale -- purchase and sale indications were oftentimes at prices that the companies did not believe accurately reflected their current valuations either to the high side or the low side. So, it was a concern in both regards.

It didn't allow the companies any opportunity to proactively control either the timing, the size of those transactions, the eligible participants on either the buy or the sell side for those transactions, and -- and didn't allow them any opportunity to influence the price at which those transactions might occur.

And so, the companies' participation on these initial platforms, these platforms that were in operation, really, until the recent past, kind of mid-2013 or late 2013, was that the company only became involved, really, at the conclusion of the transaction.

So, once buyer and seller had met and agreed, then the company was asked to grant their approval or waive their rights of first refusal so that that transfer of shares could proceed.

Again, some real shortcomings there. That was not an ideal situation for any of the participants in that transaction in that there was a frustration that could be -- could crop up at the ends of these transactions where buyer and seller had spent considerable amount of time, effort, and money in proposing these transactions that were ultimately denied by the issuer company.

From the company's standpoint, there was a concern over the impact on their cap table. So, as a private company, one of the greatest advantages you may have or may believe that you had is the ability to control the investors and your shares.

And so, with some of these transactions, companies were being forced, to some extent, to accept investors onto their cap table that they would rather not have, and obviously, there was a concern about the expansion of the cap table in sheer number. That concern was alleviated significantly by the change under the JOBS Act, but it's still a concern.

And finally, there was also a concern that the ability for buyers and sellers to access adequate disclosure from the company to appropriately price these transactions cropped up again and again. The companies that we met with would voice their concern over having any participation in these transactions.

So, as you may be aware, most of these transactions are simply purchase and sale agreements between buyer and seller. The company is not party to these transactions, and the company's concern around providing disclosure for these transactions was, if I provide disclosure, how can I ensure that everybody is receiving that disclosure equally, and what disclosure do I need to provide that will serve to be adequate to protect me from potential litigation?

So, all of these concerns cropped up for companies as they were viewing their participation or their shares transacting on some of these initial platforms.

So, again, the companies, as we met with them in 2013, generally were conflicted about an optimal solution for private share transactions in that they wanted to have proactive control over all of those components of the transaction that I discussed initially.

They sought greater efficiency in the ability to facilitate these transactions on behalf of their shareholders, but they were concerned that greater involvement increased their exposure, and that exposure was obviously to litigation, as Cromwell says, mostly to people who got involved in a trade and didn't like the way the price moved.

So, those companies asked us time and again, NASDAQ Private Market, if we would establish guidelines for adequate disclosure. And I think we have sought to develop best practices -- that is certainly a work in process -- for the NASDAQ private market, but as this market matures, I think we can become more and more confident that companies, as they follow our guidelines, will be following what is considered best practices for private companies.

So, that's among the issues that the NASDAQ Private Market seeks to address for companies, and the platform is a company-first platform. We will only transact in securities of NASDAQ Private Market member companies.

Those member companies do have to meet certain financial requirements to qualify for the NASDAQ Private Market, and we also do require certain disclosures. So, that disclosure requirement for our member companies is annual audits and quarterly updates to those audits.

It is an annual disclosure document that includes management bio's, a business description. It's loosely worded, so we allow companies to determine what they perceive as adequate there.

Finally, we do have one governance requirement that all member companies adopt an insider trading policy.

MR. KELLER: So, are you really saying, at least as it relates to eligibility to use the NASDAQ Private Market platform, that you're operating very similar to an exchange?

MR. MALIN: Similarly. Although certainly with much lighter regulation.

We do want to allow those companies to determine for themselves what they perceive as adequate, but we want to have some framework for them to rely on.

MR. KELLER: Are you finding that companies are seeing their problems addressed by this approach, or are we really coming up with what may -- identifying -- what may be an impediment to a robust private market trading system?

MR. MALIN: I would say it's early days, still.

So, the platform launched in March of this year. We have seen a number of companies who have been interested in joining NASDAQ Private Market to credential themselves as NASDAQ Private Market member companies who abide by our requirements and meet our qualification standards.

Others view us more as a platform to facilitate and enhance the efficiency of the private share transactions that they seek to facilitate, and in some cases, those companies are less interested in credentialing themselves and meeting our qualifications.

So, I think there's some different views on what the benefits of this platform are.

MR. KELLER: Just so we have it in mind, an alternative approach that's evolved is essentially the self-tender, private companies self-tender, where the company buys back shares.

Now, the problem with that, of course, is if you think of the company paying, it drains funds. It's using funds to bring shares back in when you're really seeking to raise capital. But that's been addressed by, if you will, raising money from third parties for the very purpose of, if you will, substituting -- the same private buyer that would buy shares on the secondary market might very well invest in the company, and the company would then do the buy-back and feel it has greater control over it.

MR. LUPARELLO: Just a small piece of housekeeping before we move on to Cromwell. Assuming the moderators can retain control over the panel, there should be a few minutes at the end for questions.

If you're in the audience, we encourage you to use the comment cards. If you're watching through the web cast, use the email smallbusiness@SEC.gov.

Thanks.

Cromwell?

MR. COULSON: So, we operate the exact opposite of a closed restricted trade network.

You know, we've got a free-trading market, but free-trading comes with restrictions from both brokers, from state regulators, and the way companies cure it is by providing transparency through disclosure and demonstrating their compliance with securities regulations, you know, and that's, you know, what an exchange listing is.

It is -- it's all these pieces that can build transparency and trust in the market so you can have efficient trading.

So, we came from the Pink Sheets, where I was a trader. The trading process was completely broken.

So, we built an electronic network of diverse, different, competing broker/dealers, market makers, ECNs, agency brokers, and the brokers in our market are the Citadels, the KCGs, the NYSEs, ARCA/EDGE, all the way down to small specialist bank trading firms, and you know, if you look at what we are, we're like NASDAQ --

the network NASDAQ before it became a centralized stock exchange, but with a much higher-tech and more diverse technology stack of liquidity and execution providers. And that's where I think, you know, the excitement for how to trade small companies is. You need diversity. You need different types of systems.

Roche ADRs are going to trade, you know, a lot on a fully -- on much more deeper order books than a community staff, and so, what we've done is we've put -- Pink is our open market where brokers can trade all types of securities, including very risky ones, and put the appropriate compliance processes and controls on them.

We also built a market called OTC QX, our best marketplace. It has financial standards. You need to be an operating company. You can't be a penny stock to qualify. Continuing disclosure requirements.

Exciting piece we did there in May, we introduced a product for community banks, and it fits their reporting regime to make their disclosure consistent to investors and brokers.

You're sponsored by a corporate broker. We've got the best investment banks for community banks from the top of Raymond James, Keefe Bruyette, Sandler O'Neill, to the small specialist regional shops, and there we've got 28 banks already.

They range from 130 million in assets to a billion-and-a-half in assets, and they're creating an efficient market, and that's a great creation.

Our middle market, OTC QB was based on the FINRA bulletin board model of just being SEC reporting. That didn't work. Just SEC reporting wasn't standard enough.

So, in May, we put in a standard -- there was a minimum price standard to remove the sub-penny stocks, and we were also going through a verification process.

We've gotten over 350 applications, and we've almost processed 200 companies.

This is a starting point, and the bulk of these companies are at their gate, because 120 days after their fiscal year-end, the bulk of the companies are going to take place in the first half of next year.

But we're going to have a critical mass of inter-stage companies.

And if you want to know what a venture market is, in the TSX venture, the median market cap for the TSX venture company is under $4 million. They'd like it to be $12 million.

On OTC QBR, median market cap is $11.8 million. On OTC QX, our median market cap is $48 million for U.S. companies.

So, we've created this market, and you know,

now we're going to have a critical mass of companies. And this is going to be the market where a lot of Reg A+ companies want to trade, because you can trade it through any broker. And lots of brokers that give advice -- they put restrictions on certain securities, but they also -- when companies are more transparent and demonstrate their compliance, they lift restrictions, and that's a good thing.

So, what are the changes we need?

Number one, there's the tick test. We're not the right panel to talk much about the tick test, but I can tell you, when David Weil was out there talking about tick, he wanted to foster the small company broker, the investment banking, the research, the institutional sales, and the capital market commitment.

Somehow we've got a tick test that's now about protecting the exchange model in $4 billion market cap companies -- when in reality the old NASDAQ wasn't an exchange. It wasn't a centralized exchange.

It was a network of brokers, and it was fostering these different brokers that specialized in these companies, and the internet model is all about network diversity not centralizing to one matching engine. It's about diversity, networks.

So, we should think about, if we bring tick tests into our space, it should be about more displayed liquidity. How do we have more displayed liquidity for investors, because right now, there's a 100-share minimum display size.

So, for a $5 stock, that 100-share minimum display size is $500 worth of stock. The average retail trade size is $5,000.

So, a retail investor -- if they can only get a tenth of a fill, are they going to buy? We should have a 500 or 1,000-share display requirement for market makers if we give them the extra profitability of ticks.

We also need to start thinking about, you know, how we fix blue sky, but luckily, we've spoken a bit about that. That needs to be fixed.

We need a way for companies to be in compliance with blue sky in every state.

I don't know how we do it, whether it's the states, the SEC, or Congress, but we need to do it, and we need to build a JOBS Act on-ramp so companies can come into the OTC market.

The Commissioner spoke about the need for broker/dealers to be paid as market makers. You cannot pay an investment bank to file a Form 211 with FINRA to take yourself public. You can't.

So, small companies that are unknown -- there's this black market of consultants. It's icky.

You also -- DTC has a real problem for getting DTC eligibility. We need to fix that process. How we do it -- I'm open to all ideas, but it's really important that we get out there and we fix the initial public trading for all these companies that are being created through Reg D, make an easier on-ramp.

Twenty percent of NASDAQ's new listings last quarter came from our markets. We are the market. You know, the Toronto Stock Exchange -- 30 percent of their listings have come from the TSX venture. We are the on-ramp market.

Finally, we need to fix the information for investors on the internet, and it is terrible that, in our industry, the loudest, most visible information about small caps is all these promotional websites, and there's two problems with them.

One, they're completely anonymous, and two, they can say whatever they want to say.

If you go to Google and you Google penny stocks, and you click on one of the ads, pennypicks.net -- pennypicks.net -- they're paying $20 a click for you to click on that ad, and the Penny Picks guys say individuals should go as far as assuming that all information in our newsletter about profiled companies is untrustworthy, and

MR. KELLER: That's full disclosure, right?

MR. COULSON: But it's like -- it's just -- it's unacceptable, because that scares away investors from real small companies, and it's also -- these sites are allowed to be anonymous.

Section 17(b) was written for when newsletter writers would write about -- would tout a stock and not tell their readers they were paid, but everybody knew who the newsletter writer was; it came through the mail.

Today on the internet, we've got all these anonymous sites.

You can't be paid for promotion and be anonymous, and you can't -- if you're being paid for promotion you should also say who paid you, and that's going to make it so much easier for the industry, for the brokers to do their job, because when these people who are promoters and paying for promotion are trying to deposit certificates at brokers, they can identify them as not people who should be selling shares.

I mean, this is something we need to fix, because the internet is an incredible transformer for investors in small companies, and the investor has so much more information than they had when I came into the industry 25 years ago, but we need to make sure that there's a standard in the internet, especially if you're paid for promotion or paying for promotion.

MR. KELLER: Well, I guess maybe we should now go back to Heath.

MR. ABSHURE: Don't sound so excited.

MR. KELLER: I was really going to tee it up with kind of a question which I hope is a softball, but not really, that we had started on.

Assuming that Reg A+ is adopted with some acceptable continuing reporting requirements, does that then sound like a reasonable basis upon which to say, well, you don't need state regulation of re-sales in those companies similar to not needing it when you're dealing with exchange-listed companies?

MR. ABSHURE: I think it's a reasonable basis for the states to establish a uniform re-sale exemption that would cover those transactions.

You know, as I mentioned before, no state is interested in getting in the way or inhibiting small business capital formation.

If that were the case, our bosses, my boss, the Governor, would, you know, jerk a knot in my tail, I wouldn't last very long, and in fact, we encourage -- you've got to remember, we have active investor education sections that encourage people to go out and to invest.

You know, with the '34 Act registration, looking at the primary offering, you know, you're reviewing the registration statement or you're reviewing the terms of an exemption, if applicable, but when you're talking about establishing a transparent, trustworthy secondary trading market that's really going to work, that people are going to trust and not -- it's just not going to be a cesspool of fraud -- you have to have the information there.

So, the states are concerned about striking the appropriate balance between the disclosure requirements and secondary trading.

We understand that these are going to be smaller companies. We understand that the compliance costs and their ability to handle those compliance costs is going to be a real concern.

So, we're not saying that it necessarily has to be '34 Act reports, but there has to be something there. And I think that once we establish reporting requirements that can -- because I think that -- I worry that that's all we're going to be able to rely upon, that we're not going to have the analyst coverage, we're not going to have the news coverage like we have with the blue chips and things like that, that you're only going to be able to rely on the information that's put out there by the company, and that needs to be robust information, truthful information, so investors can trust the market.

And then, with regard to fixing blue sky, blue sky isn't broken, Cromwell.

You know, we hear this a lot, and I'm certainly not saying that this was the problem in your case, that whenever an issuer has a problem clearing comments, well, blue sky is broken, because I can't get through. Well, it might be your own fault.

But the states are very aware of our need to provide uniformity and effective regulation in a way that doesn't increase the burden on the issuers and the other market participants. And we're constantly trying to refine how we do things. How we approach things, to make them much more uniform, much more streamlined, and much quicker and easier to work with for the issuers.

So, I don't want anyone to think that when we hear problems with the blue sky, we just dismiss it as sour grapes by someone who had some problems getting through there. It's not the case, although it is in Cromwell's case.

MR. COULSON: Actually, we had some errors in -- and we actually -- one state, we submitted, and then they sent us a letter approving us under the wrong piece, and then we had to go back and back out their mistake. So, it's a two-way street.

MR. ABSHURE: Exactly.

MR. COULSON: I'm not going to shame the street, the state on that one.

But it's not -- the data says otherwise -- is that -- the last state blue sky change I got for -- I saw for secondary trading was a small company called Volkswagen who was building a plant in Tennessee, and Tennessee is a tough state, and they got the state legislature to change blue sky so the employees could buy stock in Volkswagen's ADR, but that is -- and when my people spoke to the state administrators, they were really unhappy that that had been done.

So, you know, that's -- my data points are very different. They are -- mostly what Heath says is completely right.

Eighty percent of states have a workable regime. Ten percent have a painful regime but you can get there. Ten percent have a very short structure which is -- and you know, the statute starts with "N" and ends with "O" and there's nothing in between.

MR. KELLER: Well, that's how you protect investors; you keep them from investing. As Heith knows, we have the wonderful example in Massachusetts of our then-blue sky administrator thinking that this upstart company called Apple really wasn't appropriate to be sold to investors. And so, Massachusetts investors couldn't buy Apple stock except in the after-market, which is -- and pay more.

MR. ABSHURE: And that's what I was mentioning earlier. You have to remember that each state securities regulator goes out with an active investor education program and encourages their citizens to invest.

We encourage our citizens to save for a rainy day, for college funds, for retirement, and I much rather want them investing through a broker/dealer or an investment advisor than doing that on their own.

Trying to prohibit access or being an undue burden to investor access to the appropriate types of offerings is not anything that any state wants to do.

MR. KELLER: Heath, switching over to the -- call it private companies, is it unreasonable to try to develop a more uniform blue sky approach to the exemption for trading in that market, in those securities?

I mean, right now, it works in most states but not in all states, and there are different interpretations.

MR. ABSHURE: Well, you know, I guess it depends on which type of offering you're talking about, because if you're talking about someone relying on the

4(a)(1) exemption for an exchange-traded company, or an exchange-listed company, that's a covered security, right?

So, I'm assuming you're talking about, let's say, a 506 security that would normally be sold through 144 or -- .

MR. KELLER: Right. Well, a private company where

MR. ABSHURE: A 4(1 1/2) exemption?

MR. KELLER: A 4(1) -- well, really a 4(1 1/2) exemption, so that, in fact, not taking the states out of the game completely, but at least defining a workable exemption, that applies across the board so that you can have this kind of platform.

MR. ABSHURE: I think, historically, the states had relied upon the isolated non-issuer transaction in those cases, mainly because what we were worried about were affiliates using that going forward.

What we did in Arkansas was to kind of expand that and tie -- well, we -- through rulemaking, we brought the implied exemption into the rules, and then, through the statutes, we basically pulled in the 144 analysis, and if it complied with 144, you could go forward.

You know, you still have the manual exemption, which, you know, we still have a lot of issuers use that, but I think the biggest one is probably the isolated non-issuer transaction that you're going to see.

But what states have to do is dovetail that with an exemption for your affiliates, because they have to be able to sell, too.

MR. COULSON: So, just -- you know, the manual exemption is a classic. There are some states that will not give guidance on what manual is acceptable.

So, the broker/dealer community, you know, the firms that do the broker/dealer compliance for blue sky -- they will not, even if a company is in the manual, even if a company is in both manuals, Merchant and S&P -- they're the only two who exist.

And they were both going out of business until we made it a requirement of OTC QX. We brought them 370 customers, and you know -- and I look at it as the manual information -- it's very frustrating when you're trying to explain to a large European ADR issuer whose information is everywhere, and they have a very sophisticated IR team that is putting information out onto the internet under Rule 12g3-2(b) and lots of analyst reports -- is why they should be in this book in the library in America?

And you know, it's something of -- how do we make it work? Because at the end of the day -- we want the investor to have the information on their screen when they're making the trading decision. And today investors have, through E*TRADE, through Yahoo Finance, you know, they have an incredible amount of resources there. I mean, but we -- you know, for community banks, they questioned the manual piece, so we didn't make it a full requirement, but you know, on community banks, Heath's state, again, has a bank holding company exemption, really good act.

If we could have Arkansas across every other jurisdiction, it would be great. But 23 states, if you're not in the manual; if you're in the manual, you get a bit more, but it still doesn't -- and these are audited -- PCAOB audited financials and their main subsidiary is a federally regulated bank.

I mean, this is -- and they're making consistent disclosure. The disclosure they publish through us is, you know, sent to Bloomberg, free on the internet for investors.

MR. ABSHURE: Is the disclosure published through you guys -- is that provided by the issuer, or is that obligation on the market maker?

MR. COULSON: It's on the issuer.

MR. ABSHURE: It's been a long time since I've done anything with the Pinks, but when I -- of course, the last time I did it -- it's been years ago, but you -- as an issuer, you didn't apply for listing. You had a market maker that would --

MR. COULSON: You don’t apply. The Pink Sheets -- in our OTC Pink, the brokers are quoting to deliver best execution, and we're hugely regulated on the brokers for best execution.

You know, Steve's staff is all over both all the broker/dealers and ourselves, and you know, we're going to be a Reg SCI entity, is -- so, it's very heavily regulated on the trading process.

What we've layered in is issuer requirements to move up. If a company doesn't provide information, they are -- you know, we put a stop sign in their Pink --

MR. KELLER: I’ll cut in there. We promised we'd give others the opportunity to participate -- one of the ground rules.

MR. LUPARELLO: Okay. I have a couple of questions for Cromwell, which I’ll hold until the end.

MR. COULSON: Ninety-five percent of our dollar volume is companies with current information available, either through the SEC, through Rule 12g3-2b, through bank disclosure, or through our alternative reporting. And so, you know, it really shows, there's not much liquidity to a company, if you're not making disclosure, and those -- you know, and there's lots of broker restrictions on those securities.

MR. ABSHURE: With regard to the manual exemption, that's not anything you push. For us, the manual exemption is just that, it's a recognition that it's one avenue for a company to provide that disclosure, and if they choose to go that way, you know what, they've got a re-sale exemption.

MR. LUPARELLO: Okay, gentlemen. Take it outside.

Okay. I’m going to hit a couple of factual ones in aid of the breakout sessions. Maybe we’ll get to the more intricate ones after that. Can non-U.S. companies list on the NASDAQ Private Market?

I'm sure "list" is not the right word inn that context, but I'll gloss over that for a second.

MR. MALIN: There's ongoing evaluation there. The companies on our platform, if they are going to engage in transactions, are all represented by broker/dealers.

So, at least our initial law firm view is that the broker, if it is registered where that company is domiciled and has the ability to then passport that, via their affiliates, to U.S. investors, perhaps, that is okay.

I'm certainly speaking out of turn, because I'm not the compliance lawyer or chief counsel of NASDAQ Private Market, but that's my understanding, is that is the route we are likely to follow if the broker/dealer can take the responsibility for determining whether that company's shares can be sold in whatever jurisdiction they're anticipating they will be sold, then it's eligible to do that via our platform.

MR. LUPARELLO: Vladimir, a couple of factual questions.

Has DERA made any efforts to quantify or estimate the actual size of the Reg D market, including those that don't file Form D?

I know you said that it was not in the numbers you were presenting, but has there been a broader attempt to scope it, even generally?

MR. IVANOV: Yes, we have. We use data from investment advisors who have to report private offerings, and so, we check, you know, how much of this reporting is in our, you know, EDGAR.

So, we -- the estimate we got is that about 10 percent of issuers do not file Form D, but again, this is only for those issuers that use an investment advisor or broker/dealer.

So, we don't know, if an issuer doesn't use any of these, how many of them or what fraction doesn't file

Form D.

So, for the ones that use broker/dealers, investment advisors, about 10 percent do not file Form D.

MR. LUPARELLO: And while we're picking your brain, do you know what percentage of 506(c) investors are also -- is that a number that you have looked at?

MR. IVANOV: I don't think we have looked at it. I don't think we can identify it. We don't have the information to identify it.

MR. LUPARELLO: Does the panel have thoughts on lessening the compliance and due diligence costs for broker/dealers transacting in securities of companies under different disclosure and information regimes, private OTC, public listed markets? That was also the lines of -- I think Cromwell had touched on it a little bit. Heath, as well.

I think I certainly have a point of view on that, but I'll let you guys go first.

MR. COULSON: The way the market structure works in our market is that securities are traded by mostly large electronic wholesalers, and they're really focused on matching buyers and sellers.

They don't have a team of analysts saying, oh, wow, it's trading at $2.30 and it's actually worth $3.50, and in fact, if one of their traders said that, their compliance team would probably fire them, and so, there's a matching of sellers piece.

So, it's one of the challenges, is we've got a regime in Rule 15c2-11, which was really built about companies bringing securities into the market, and how do we make that work? That initial company's coming in, because it worked for well-known issuers. It's a little inefficient for large international companies, because it just takes too long for FINRA to process, and the SEC is having great discussions on that.

But for small unknown companies, as a broker/dealer, you can't be paid to review the disclosure, and that's a problem, because for a broker, there's a risk profile. While it's not a due diligence standard, it's -- you know, it's a reasonable belief standard. But this black market has been created of consultants who somehow know someone unregulated, and every once in a while, FINRA will do a case against someone who is doing very low-quality 2-11 filings, and there was a check deposited in the guy's wife's bank account, that said "for filing Form 211s." The Legacy Trading/ Mark Uselton case, is -- is that -- but it's a lot of work for the SEC to figure out.

So, it would be much better if we can start saying, okay, let's get the investment banking department to be able to take existing securities and create a public market, and offer it as a service, because we have all these securities in the private market, that they should be able to benefit if they want to -- if they want to have a closed market where they're condensing their capital table, NASDAQ Private Market can be a great option. But if they want to, they should come in with good advice, and let's build these little investment banks.

So, that's my issue.

On the other side is, to a trader in -- once there's a market established, you need the disclosure to go out widely, and then the trader is going to look and say is a buyer or a seller coming? You know, and then they're going to adjust their prices based on demand, so -- and if there's no information, which Facebook traded on -- on second markets before, investors can still buy and sell these things, but you've got to have a level of sophistication, and you also need the risk warning that, hey, this is all based on supply-demand, not valuation.

MR. ZUPPONE: I actually have some thoughts on the primary offering.

If you posit for a moment that the reduced disclosure format will reduce dramatically the page count in an offering circular as compared to an S-1 prospectus

-- take, for example, shrinking compensation disclosure from 30 pages to maybe 5 pages, or an MD&A disclosure from 20 pages to 5 pages.

There's going to be a natural scaling, I think, of -- at least from a securities law practitioner's perspective -- of the diligence exercise to sort of confirm the disclosures, because it will be reduced.

Can I tie a number to that? Probably not, but my sense is that, certainly from the cost of the legal diligence exercise that you have for any public offering, there will be a reduction that will follow.

MR. KELLER: I think we have come to the end of our time. Let me make one comment, and then turn it over to see if there's another.

We have spent a lot of time, I think, over the years -- most recently, the JOBS Act -- and we have now JOBS Act 2.0 -- mostly focusing on the regulation of primary offerings and unregistered raising of capital, and certainly the Commission has done that over the years, and it seems to me there's an opportunity to bring the same level of attention to the resale regime that we have, and I'm thinking now just from an SEC regulatory point of view.

To take an example, we have a number of rules that provide clear safe harbors, Reg D. Reg D is limited to issuers.

I don't think it would take a lot of brain damage to think about the ability to expand some of those to, if you will, non-issuer transactions.

Rule 144 has been an amazing advance, and it's been modernized, kept up to date, but there's still problem areas.

One obvious one that comes up every year is the shell company problem where a company once was a shell company but no longer is. It really is time to fix that.

The other is the problems encountered with the Form 144 filing, which invariably the brokers manage to send it a couple of days late, if at all, and are there ways to address that, the same way we addressed the Form D problem by not making it a condition or by building in an innocent and immaterial exception.

So, I think there are things that can be done that shouldn't be that hard on the regulatory side.

Commissioner Piwowar, any closing remarks you'd like to make?

MR. PIWOWAR: Sure. Just three quick observations.

First, I could listen to Cromwell and Heath debate blue sky laws all day long, so that's great.

One of the metrics I use in terms of evaluating whether a panel is successful or not is the amount of disagreement among the panelists, and so, on that note, I think this was a highly successful panel, so -- one of the best that we've had. So, that's great.

I think Stanley mentioned -- I forget how he said, but he sort of jokingly -- he said the best way to protect investors is to prohibit them from investing in securities, right?

And I think there's sort of this natural reaction that, from those -- from those that have sort of an investor protection view of the world, that -- you know, let's take fraud off the table, but that somehow investors would be worse off if they were allowed to invest in riskier securities.

Somehow the average investor would be worse off if they were allowed to invest in, you know, the riskiest, maybe the smallest startups, crowdfunding, maybe private securities offerings, and we know small cap stocks are, on average, riskier than large cap stocks, but what's missing in that -- and this comes from my -- my old finance professor background -- is it's not the case that just because a security or an issuer or a company is riskier, on average, in isolation compared to what the investor already has in their portfolio, it's not the case that if they add that security to their portfolio that somehow their portfolio is riskier.

What matters is not only the individual risk of a security, but how that security is correlated with other securities in the portfolio, and so, there's this counterintuitive result that, by opening up the universe of securities that investors can invest in, whether we call them accredited or qualified or whatever name we want to put on them, that actually by opening up that universe to securities that are not correlated, that are different from the securities that are already in their portfolio, we can actually help them in terms of getting a higher expected return and possibly also a lower risk.

And then, finally, I just want to thank all the panelists. I think they teed up a lot of the issues very nicely. I note that this afternoon there is the breakout session. It's sort of the follow-on to this one, and I look forward to the recommendations that come out of that.

Thank you.

MR. GOMEZ ABERO: Thank you to Commissioner Piwowar.

Thank you to all the panelists and the moderators. Great discussion this morning.

Let's take a very short break, trying to stay on schedule. Let's come back at 11:25, where we'll start with remarks from Commissioner Stein, and then we'll move on to the accredited investor panel.

Thank you.

(Recess.)

MR. GOMEZ ABERO: We'd like to go ahead and get started.

We'll start with the remarks from Commissioner Stein.

Thank you. Keith, shall we get started?

Introduction of SEC Commissioner Stein

MR. HIGGINS: Thanks, Sebastian.

As people starting winding back, let me welcome -- if I could get everybody to return to his or her seats. Thanks.

I'd like to welcome Commissioner Kara Stein, who is joining us for this panel.

Commissioner Stein became a Commissioner in August of last year. Prior to that time, she was working in the Senate and was staff director of the subcommittee that oversees the SEC and worked for Senator Reid. She's also been in private practice, been a law professor. So, we're delighted to have you join us, and let me turn it over to you.

Remarks by SEC Commissioner Kara M. Stein

MS. STEIN: Thank you, Keith.

I want to add my welcome to all of you in the audience, in addition to those of my fellow Commissioners who were here earlier this morning. It's truly a pleasure to be with you to discuss this very important topic.

I have been particularly focused on this topic, you know, basically because smart policies around capital formation, particularly for small businesses, will lead to good jobs and healthy investment opportunities across America.

I recently went out to L.A. to the so-called Silicon Beach. I had the privilege of visiting a technology accelerator at University of Southern California's Viterbi School of Engineering, called the Startup Garage, and the people I met -- a lot of them were young people in that -- as well as their ideas were really exciting, and a lot of them were struggling to figure out how to get the next infusion of capital.

A lot of them had gotten $10 to $20 thousand dollar amounts of capital to sort of get their project off the ground.

So, that brought it home to me. You know, now more than ever, America's small businesses need smart, well integrated, workable rules that facilitate capital formation and healthy markets that will give investors the confidence to invest. That's the tension.

And as I've been saying recently, instead of a careful and thoughtful continuum of capital formation, we have a jumble of overlapping and inconsistent options from both private and public capital raising.

The system, as you know, has become increasingly complex. It is, at times, irrational, and it contains gaps. It both inhibits efficient capital formation at some stages, while needlessly exposing investors to undue risks at others.

We can, and we should rationalize this patchwork quilt. It will benefit both entrepreneurs and investors. So, I hope that some of that good thinking will be done today on both this morning's panels and the breakout sessions.

I also believe that many of the ideas for doing so share broad support from across the policy spectrum. For example, Commissioner Gallagher's idea about venture exchanges, which my trusty staff tells me he mentioned this morning, and my views about rebuilding regional exchanges, may offer, I hope, promise for progress.

At the same time, I also share Commissioner Aguilar and others' concerns about the practical realities and risk when dealing with small issuers and less liquid -- especially the retail over-the-counter -- markets.

We have to be smart, practical, willing to both experiment and adapt, as we see issues emerge.

In short, I'm very focused on working through the issues you're discussing today, and as part of that effort, I want to see the Commission move quickly towards finalizing three very important rules related to capital formation: crowdfunding, the new Reg A+, and certain investor protections under Rule 506.

Moreover, as I've said before, we should be able to walk and chew gum at the same time. Even as we work to rationalize and improve the entire system, we should move as quickly as possible to finalize the proposals that are before us.

These particular rules arise from laws passed two-and-a-half years ago, and Congress is looking to us to get them done.

They worked hard to make sure the Commission had the authority to establish appropriate protections around new ideas like crowdfunding so they can blossom into healthy, durable markets.

So, I hope we can move quickly on these, and of course, all of our other congressionally mandated obligations, but quite frankly, I don't think we're very far away on some of these particular rules, so let's get them done.

So, thank you again for coming to the small business forum today, for taking time out of your busy schedules to participate, and I look forward to the dialogue.

Panel Discussion: Should the Commission Revise the Accredited Investor Definition?

MR. HIGGINS: Thanks, Commissioner Stein.

So, we'll go ahead and get started with the second panel. It's going to be a quite exciting topic. It's going to explore whether the Commission should revise the accredited investor definition.

As others have mentioned this morning, under the Dodd-Frank Act, the Commission was directed to undertake a review of the accredited investor definition as it applies to natural persons, and determine whether it should be modified for the protection of investors in the public interest in light of the economy. This review was to be undertaken after July of this year, and we were prohibited, actually from amending the net worth test in the definition before July.

In any event, as the Chair mentioned, the staff in our division, as well as in the Division of Economic Risk Analysis, are currently engaged in that review.

So, this discussion is particularly timely, both this morning’s discussion, as well as in the breakout panel, will help us to inform better the review that the Commission does.

As Commissioner Aguilar mentioned, the Investor Advisory Committee has provided some thoughtful recommendations, and we look forward to getting the benefit of the forum's views on this, as well.

I'd like to thank Stan Keller for agreeing to moderate this panel again with me. Stan was already introduced by Steve Luparello. I won't go over that again.

I will say, on a personal note, that Stan and I have known each other for probably more years than either of us would care to admit, and I have always looked to Stan as one of the leaders of the securities bar, and I'm certainly delighted he can be with us today.

So, Stan, let me turn it over to you to introduce the panelists and get the discussion rolling.

Should the Commission Revisit the Accredited Investor Definition?

MR. KELLER: Thank you, Keith.

Again, we have, I think, an outstanding panel to cover this particular subject, and let me begin by introducing them.

Rachita Gullapalli is going to start us off, and we'll turn to her in a moment. Rachita is a financial economist with DERA, and I've given the full name of DERA before; I won't do it again.

Next is Don Langevoort, who is well known to many of you, and has participated in this conference before. He's the Reynolds Professor of Law at Georgetown University Law Center and a recognized expert from academia on securities laws through his writings, his lecturing, and his speaking.

Next is Jean Peters, who is Managing Director of Golden Seeds, which is an angel investor group, and Jean is also a board member of the Angel Capital Association, so a real life angel investor, and in a past life was -- I found this fascinating to read -- a financial journalist and a policy analyst on Capitol Hill.

And Heath Abshure, by now, is very well known to you, and again will wear his hat as the Securities Commissioner of Arkansas and a past President of NASAA, and I think we have established that he is an outstanding State Securities Commissioner.

Let me begin, as I did before, just by teeing up some issues, some questions, and providing some context.

We have a current definition of “accredited investor.” For individuals, it's based on wealth or income, and there's also a category of entities, which is either a categorical exemption, or based upon total assets.

I don't have to tell you folks what the exact tests are. We'll leave that to come up.

We're going to focus on this panel essentially on the natural person definition, because I think that's where all the action is.

In talking about the accredited investor definition, it's important to have in mind the role it plays in securities regulation, and I've listed on the slide the three basic roles.

The historic role was to bring certainty to certain aspects of Rule 506, the 4(2) private offering safe harbor under Regulation D. And accredited investor tells you who you do not have to count for the 35-investor limit, and who you do not have to provide the required, the specified information -- in and of itself, I think, has made the use of 506 essentially an accredited investor exemption.

This is also true for the statutory analog under Section 4(a)(5), but that's not looked to all that much, so just think about 506.

Second and most recently, since the JOBS Act, the definition of accredited investor now tells us who you may generally solicit, so long as you take the additional step, not just of having a reasonable belief or of being lucky and having your investor be -- turn out to be an accredited investor -- but actually taking affirmative steps to verify that person's status.

So, it's who you can now generally solicit under 506(c).

And finally, and I think very significantly -- and I'm not sure it's been fully appreciated yet -- it identifies those holders of record who do not count towards the 500 limit, until you get up to the 2,000 limit (i.e. those holders of record, shareholders of record who let you get above that 500 all the way up to the now expanded 2,000) before you have to come under the SEC's system.

In assessing the accredited investor definition, I think we can all start with a basic agreement, and that's the desirability, as we heard earlier, of balancing investor protection and facilitation of capital formation, and we can also agree on the importance of confidence of investors to the capital formation process.

So, while one can look at them on opposite ends of the spectrum, there is an important overlap between the two, and the issue that we're going to be talking about and focusing on and that will influence, I think, each of our views on this subject is, how do you strike the right balance between these two considerations?

If you tighten the definition, it lessens the pool of eligible investors, and it can impair capital formation. If you expand it, it enhances capital formation, but there may be investor protection issues.

The definition itself that we've been living with for many years now is designed to be a surrogate or, if you will, a proxy for the Ralston Purina test set down a long time ago for sophistication and ability to fend for oneself or -- and I don't think has been mentioned yet, and I think it was in the original thinking when Reg D was developed -- who is in a position to hire someone who can assist them to fend for themselves or can provide the requisite sophistication.

And then, I think, secondarily, it exists -- and I say secondarily -- for those who can bear the risk of loss of the investment.

And the question I think I'll throw out there that may percolate through the discussion is, is precision necessary or, indeed, desirable? Or, are we seeking just a general approximation, if you will, for what is this surrogate for the ability to fend for oneself or have a sophistication? Or, put another way, should we approach this question theoretically, or analytically, or should we approach it with a fair amount of practicality and pragmatism to be applied to how we come out?

There have been a number of alternatives that have been discussed. One is to scrap the wealth/income test as not really being apt in getting at who is -- has the requisite sophistication -- and adopt what has been described as a true sophistication test.

So, we have the recommendations of the Commission’s Investor Advisory Committee that issued a very thoughtful paper analyzing the current tests and their recommendations.

Should we add qualitative sophistication criteria to the existing tests, as an alternative, a way of expanding the definition, by saying, hey, there are smart people who may not be rich?

Three, should we be indexing what is now longstanding dollar denominated values, and if we do index, should it be done retroactively, picking up, if you will, the inflation rate, the change in the value of the dollar since the test was first put on the table? Or should we be indexing on a prospective basis, which gets into the question, are there reasons for indexing, or does indexing really not get at what's important here?

And finally, we heard something of a pitch by one of the Commissioners which gathered applause from the audience, do nothing. And I would say, do nothing based on the absence of clear evidence that there is a problem that needs to be resolved.

So, maybe just summing that up, what are the factors that need to be taken into account to balance it?

Well, investor protection. And does a change in the definition, or the particular change, enhance investor protection? And as I said, is there a problem in need of fixing? How does it affect capital formation? Is it being enhanced or impaired? Is the test that we come up with, that the Commission comes up with, one that is workable?

We can come up with the perfect test, but it may be very hard to apply, and this is an area where one might put a high premium on workability, since real people need to deal with it.

Similar to that, is it a test that's verifiable, given that if you want to use 506(c), you have to take reasonable steps to verify. And finally, there's the backdrop of all of those political ramifications that the Commission has to consider in whatever it does in this area.

Let me now turn it over, on the notion that, while it's a lot of fun to talk in the abstract and theoretically, sometimes we have to let the hard facts interfere with that thinking, so we'll ask Rachita to give us some background on some of the facts that the Commission has.

MS. GULLAPALLI: So, I will be providing some information on the pool of accredited investors as they pertain to natural persons, and what the pool is currently, and how it might change under alternative adjustments to the criteria.

So, we are all aware, like for the existing standard for natural persons to qualify as accredited investors, they need to have at least -- income of at least $200,000 or joint income with spouse of at least $300,000, or they should have net worth, individual or joint, to be at least one million dollars, and this excludes the value of the primary residence and any indebtedness associated with it.

So, the standards were established in 1982, and they have remained so for the past 30 or more years, and the joint income standard was established in 1988, and the net worth standard, the adjustment for excluding the primary resident, was done recently, in 2011. But since -- other than those, the standards have remained more or less intact, and one of the proposals that was before the Commission in 2007, and also in the public domain, is to adjust these thresholds for inflation since

1982, and the table here basically presented what these thresholds would look like if we adjust them for inflation.

So, as you can see, individual income of $200,000 in 1982 terms is equivalent to about $492,000 as of August 2014. Similarly, the joint income, which was established as $300,000 in 1988, would be equivalent to $628,000 in today's dollar terms, and net worth of one million dollars would increase to $2,464,000 in 2014 terms.

So, the question is, how does this affect the accredited investor pool?

In order to estimate the number of natural persons or households that qualify as accredited investors, we have relied on the Survey of Consumer Finances. It's a triennial survey conducted by the Federal Reserve Board. It has extensive information on assets and financing and liabilities of U.S. households and is representative of U.S. population in terms of households.

So, the second column of data basically shows what proportion, or what's the number of U.S. households that would qualify as accredited investors under the current standard.

So, as you can see, about 7.86 million

households would qualify as accredited investors under the $200,000 individual income standard, and about 4 million households would qualify under joint income standard, and 9 million or so households would qualify under the net worth standard.

So, if it's either of these, then it would be about 12 million households, which represents 9.9 percent of all U.S. households.

So, to provide some perspective as to what these numbers looked like in 1982 when the rule was first -- when the standards were first set -- we relied on the 1983 Consumer Finances Survey, and we found that, based on the $200,000 income threshold, about half-a-million households would have qualified, and based on the net worth threshold of $1 million, 1.4 million households would have qualified, and these would have amounted to 1.8 percent of the total population.

So, going to the third column of data, this is what's the proportion of households, or what's the number that would qualify if we adjust the income and net worth thresholds to current dollar terms.

So, as expected, the number of households that qualify under individual income standard would reduce to 2 million households, and under the net worth standard, it would reduce to 3.83 million households.

So, overall, about 4.3 million households would now be in the accredited investor pool if we adjust the thresholds for inflation, and this amounts to 3.5 percent of U.S. population of 122 million households.

So, another proposal which has been around is the issue of whether retirement assets should be excluded when we calculate the net worth threshold, the idea being that these assets are used -- are a source of income for retirees and also people when they move into retirement.

So, from that perspective, we have tried to recalculate the numbers if we exclude retirement assets from net worth.

So, we find that the number of households that qualify under the net worth standard would shrink from 3.8 million to about 3 million households, which implies that the overall pool of accredited investors would shrink somewhat from 12.15 to 3.77 households, which is about 3 percent of the U.S. population.

And for the last slide, we provide some numbers for alternate criterion of minimum investments.

This was, again -- this had been proposed in 2007 by the Commission, and we have used the same assumption of $750,000 in minimum investments. So, as you can see in the second column of data, if we include this criterion, about 8.8 million households would qualify solely on this criterion.

And if we look at the alternate criterion of income, net worth, or minimum investments, it's about 9 million households, which is about 7.4 percent of the population.

And again, the last column shows the same numbers if we exclude retirement assets from minimum investments, given that we consider retirement assets to be safe assets and they might not necessarily indicate sophistication.

So, the numbers shrink further. 5.8 million households would qualify under the new net worth standard, and the overall pool of accredited investors will be 6.29 million households.

So, with this, I turn it over to Professor Langevoort.

MR. LANGEVOORT: Okay. Thank you.

It's an honor to be here. I also accepted this invitation with some degree of trepidation, because to me -- and I was on the Commission staff when the phrase "accredited investor" was invented, and I've taught it for about 34 years.

The question of what the standard should be for accredited investor is unanswerable except as a political question. There is no analytical basis unless you assume the conclusion.

Many people who talk about accredited investor say it's a proxy for "can fend for themselves," the phrase that we take from the Supreme Court's Ralston Purina decision, but if we took that seriously, we'd bring down the definition of accredited investor to near zero.

For certain kinds of investment, as institutional behavior leading up to the financial crisis has shown us, there are lots of the biggest institutions in the world that don't fend for themselves particularly well.

We know there are agency costs, information problems, and a variety of reasons they invest poorly some of the time.

As you extend that to retail investors, all of our scientific evidence, all of our research suggests that there are systematic flaws in how people make investment decisions.

Certainly, for senior citizens, to me the most sensitive group in need of protection, we know that there is cognitive decline that sets in, sadly, at an age earlier than I am right now, and that grows over time. But more than that, when you're on a fixed income, and staring at the amount you have left, and wondering how long you'll live, anxiety and fear and a variety of other emotions make you particularly susceptible to bad decisions.

I don't think fending for yourself is a good way of answering this question, unless we want to move backwards in the direction of much greater regulation, and for reasons Stan said, I'm not here today to suggest that that be the case.

So, what else could be our baseline? We can certainly ask in terms of could you hire an advisor? Could somebody be protecting you? But to me, that just takes us from one troubling world to another.

Conflicts of interest in investor advisory relationships, especially in darkened spaces like these are problematic. I think the evidence on what investors pay and what degree of protection they get would cause us to be troubled.

So, I'm left with a normative approach to the question, but one that palpably leads to no obvious answer.

To me, the definition of accredited investor should be the person that society expects to be able to say no, that I don't understand the investment enough, and because I don't understand it, I am not going to invest.

Descriptively, sadly, not enough of us are capable of doing that.

Too many of us are susceptible to the sales pitches and other pressures that can come in that setting, but I think most people who advocate a relatively low threshold for accredited investor aren't using that descriptive methodology.

What they're saying is, as a matter of norm, as a matter of expectation, certain people, being grownups, should be able to decide for themselves whether to invest or not, whether to take that risk, and this is a proxy for that.

To me, that's a purely political question that gets us back to the tradeoffs.

I would personally raise the threshold a bit but not by much. I think the right tradeoff, given the need to encourage capital formation, is a little bit above where it is, but that's intuition on my part.

I can't say -- you know, alot about the research on this subject. I can't say anybody could draw from that.

Having said that -- and I know you want us to stay to about five minutes, so I'm going to finish up very quickly.

Having said that, to me, my -- the strength of my feelings about where we ought to set the accredited investor definition depends on the answer to a bunch of other questions. Private offerings are an ecology. There are many different aspects to that, the most important of which is how much sunlight do we have? How much do we know? If I knew what the added payoff to a portfolio is from being able to add a greater number of private investments, I'd feel more comfortable answering questions like this, but we don't know that.

I would like to know the incidence of fraud in this area, what the returns to investors are from the various categories of investments that are sold in the private space. We don't know that either.

We look at certain information, and you just saw it here, that tells us who, but how that person does, what it does to the retirement savings, those kinds of things, we just don't know.

So, if I have a bottom line here, I guess I would push, nudge the definition up a little bit. But if you ask for my strongest preference, I think FINRA and the SEC have to go to work very vigorously on bringing much more sunlight and much more knowledge to this area than we have.

Sadly, some of the political pushback that I've seen is in the exact opposite direction, somehow a right to privacy, that these things ought to be dark spaces, because investors can fend for themselves. That's what we said when we declared them accredited investors. To me, that's nonsense.

So, the Commission's proposals on Reg D, on Form D, on bringing more information, FINRA's proposal on what gets -- proposals and adopted rules on what gets filed, centralizing information flow, having the technology budget in order to bring much more to bear on these private markets are, to me, the prime imperative.

Tell me we've solved that problem, the sales pressure problem, the suitability problem, the sunlight problem, in a reasonable way, I'll leave accredited investor where it is. Leave too much darkness in this space, I think it becomes a moral imperative to do something with it.

MR. HIGGINS: Don, can I say -- is the sunlight -- is the transparency in the sales practices area is it in the information that investors get about the investment that they're making? You know, the financial statements and --

MR. LANGEVOORT: To me -- this is an academic-y kind of response.

I've always thought the real -- the Supreme Court got it wrong in Ralston Purina in defining what public -- to me, public offering is when you are selling a large enough amount of securities to require unusual sales pressure in order to move it in a short period of time. So, it's all about sales pressure.

But the Commission -- I think it was in 2000 -- did a nice little study called "Keeping Apace with Cyberspace" that reminds us very well that sales pressure comes in a variety of forms, that push and pull technology, as Amazon well knows, can be as effective at stimulating choices as a registered rep on the other end of the phone or the other end of an email.

So, I'm going to fight you on whether there really is a clean distinction between information and sales practice. But yes, I think -- I always go back to the idea, securities are sold, not bought, that there is much to the belief that it's -- somebody engaged in fairly aggressive influence activity that is at work here. That's what I think needs to be addressed.

MR. KELLER: A comment on that. It strikes me that, under the law of unintended consequences, the addition of 506(c) puts more pressure, if you will, on the definition of accredited investor, because those are the opportunities to engage in the sales practices and solicitation to do it legally, as opposed to what was going on before that puts pressure on that.

But Don, I was interested that in your

analysis, you didn't take into account experience, which unlike when you were at the Commission, having to come up with a definition of accredited investor from scratch, we've had at least three decades of experience.

Now, against that experience, there have been changes in the world, if you will, in communications, ready access to information, one could say, increased sophistication of investors. The flip side is the ability to more easily reach people through general solicitation.

MR. LANGEVOORT: Right. Well, if your question goes to learning from experience, which I think is --

MR. KELLER: Take into account the benefit of the experience of what has happened.

MR. LANGEVOORT: But it goes back to -- I've been asked the question, oh, how much fraud is there, really, in the small business space? I can't answer that question. We do not have good enough data to say we know from experience what the consequence has been.

Give me more data. I think the Commission would have a lot to learn. But I -- when you shut off the lights or when the lights are off, to say, oh, we didn't notice enough problems to justify taking action now, you're probably not acting wisely.

So, I think we have much to learn before we can judge what experience teaches us.

MR. ABSHURE: Professor, I have a question for you. You're going to know this much better than I, cause it's been a while since I've looked at it.

I believe the Ralston Purina case involved an offering to employees of the company, and what the court said -- there were two factors there.

One was the limited nature of the offering and then the fact that the employees, the offerees, didn't need the type of information that a registration statement would provide.

Out of that is born 4(2) and where we are now with 506. But considering where we are now with 506, that the limited nature of the offering is general solicitation and the persons that are able to fend for themselves or don't need the type of information the registration statement should provide are just accredited investors.

Are you saying that we should -- not only should we -- it seems to me that we either redefine accredited investor to get back to that idea, or understand that times have changed, things have changed, and scrap our ideas around private placements altogether, and rebuild that distinction between a public and private offering?

MR. LANGEVOORT: I think I'll agree with you. I think what I said is Ralston Purina, which gives us little more than "can they fend for themselves" -- it rejects numbers, it rejects nearly everything that would be an objective criterion -- is simply not an adequate way to address capital raising needs/investor protection tradeoff.

So, yes, what Commissioner Stein was saying before, yes, we should go back and reinvent the wheel, but I know what happens when the Commission tries to reinvent the wheel.

MR. ABSHURE: I guess my real question is, can we fix the accredited investor definition without just going the extra step and fixing Section 4(2) altogether?

MR. LANGEVOORT: As I said, to me, accredited investor is a subsidiary question to “have you got the regulatory ecology right,” which is a sunlight disclosure question. “What platforms do we have for trading?”...

All of those are relevant. Accredited investor is one piece of the puzzle.

So, if that's a way of agreeing with you --

MR. ABSHURE: I like it.

MR. LANGEVOORT: -- then I agree with you.

MR. KELLER: Maybe we should ask Jean to give us the benefit of her perspective.

MS. PETERS: Thank you, Stan, and thank you to the SEC, Sebastian and the Commission, for inviting the Angel Capital Association to be here today.

The accredited investor definition is one of the most important issues facing ACA. You know, we are all about ensuring -- trying to ensure that angels who understand this asset class can continue to invest prudently.

Angel investing creates jobs. It's the largest source of capital that spurs innovation in high-growth engines of our economy.

I note in passing that today is also global angel -- business angels day, which is designed to enhance the connection between startup communities and policymakers, and I sincerely hope my comments today can somewhat do the same.

ACA is the world's largest association of accredited investors. It's grown in line with the dramatic increase in angel investing over the past decade. Ten years ago, there were only about 50 angel groups in the country. Today, there are nearly 400, the majority of which are in ACA.

Each year, ACA provides -- hosts dozens of forums, webinars, training sessions designed to develop smarter, more successful accredited investors. And if you want to become a small angel investor, I urge you to check out the website.

We, of course, support the objectives of the SEC, of investor protection, maintaining a free flow of capital to entrepreneurs and market integrity.

There are, of course, as Professor Langevoort said, individuals who can be mistakenly persuaded to enter into any number of inappropriate investment options, whether they're publicly registered or private.

Angel investing, however, holds a particularly critical place in the capital stack. That's because it's Ground Zero for getting innovative companies, technologies, and ideas off the ground. It's the primary force of funding for the startup economy.

In 2013, angels invested about $25 billion in 71,000 companies, very close to what venture capital invested in total, and these are the types of enterprises that have created nearly all the net new jobs over the past several decades.

Today angel groups and accredited platforms act with processes that are similar to venture capital. The main differences are angel investors use their own money and invest almost entirely in the seed state, early stage where capital formation is really happening.

Venture capital generally employs other

people's money and is mostly allocated to the expansion stage of companies that have been fairly well de-risked. Of the $28 billion of venture capital in 2013, only about $3 billion went to the early stage companies, and only about 3,000 companies.

So, where do angels invest? They are particularly critical in what we call the flyover states, where venture capital was virtually nonexistent.

This is the Halo report, a quarterly survey of angel investing done by CB Insights, Silicon Valley Bank, and the Angel Resource Institute. It demonstrates that nearly 60 percent of angel investment is outside of the quarters of Silicon Valley, Boston, and New York.

It's hands-on work. It's not passive. We invest -- we identify potential investments from many sources, from universities to economic development agencies, and public and privately funded incubators and accelerators.

There's extensive due diligence. There is an information flow that we access and negotiate to continue to access on an ongoing basis.

Only a handful of applicants make it through this process. About 90 percent are rejected at the gate. It's really not a place for fraudsters to apply.

Startup funding would be devastated if the financial thresholds were adjusted, as Rachita indicated, for inflation.

As the GAO notes -- and this was based on earlier data -- I think Rachita's data is more up to date, maybe making this a little more difficult -- nearly 60 percent of all those who currently qualify as accredited would be excluded under an inflation adjustment.

ACA surveyed its own membership, and outside of New England and California, where about a quarter of the -- our members would cease to be accredited, in the rest of the country it's nearly a third.

A recent report from Brookings, in July, indicates that, you know, new business formation is actually declining, even in Silicon Valley. Meanwhile, economic development agencies and universities are promoting entrepreneurship as hard as they can.

It's clear the economy needs more smart angels, not fewer, and if you're adjusting the side of the equation for inflation of income and wealth, you perhaps ought to look at the adjustment on the other side of the market and look at what the size of the private market was in 1982 when there essentially was no private equity and it was -- maybe we can't quantify it, but certainly very tiny.

If you raise the access to that market by -- the change in that size of that market relative to the public markets, I think the choices might be somewhat different.

On the issue of issuer verification, general solicitation was intended to broaden access to capital for small business, and in many cases, it has had the opposite effect, and I think the numbers of how few companies are taking advantage of this is arguably evidence of that.

First, there's no clear definition of general solicitation. There's no guidance, clear guidance, on whether a university tech fair or an accelerator pitch day or an economic development event for small startups qualifies as general solicitation.

So, as a result, attorneys and advisors are advising angels and entrepreneurs to play by 506(c) rules, which leads to the thorny problem of verification.

Angel investors act willingly, but privately, and the added layer of regulation puts obstacles in the middle of this funding process and can tip the balance of angels simply saying no.

The entrepreneur is kind of set up as a, you know, quasi-antagonist to the -- to the person he's trying to ask money from by having to put this additional

-- some of these additional steps in, and the risks of them messing up general solicitation are so great that it's just another side of the risk equation that makes this process almost impossible.

So, we have found that most of the angel groups in ACA will actually only consider 506(b) deals. That really just negates the JOBS Act intent entirely.

So, it's gratifying that the title of this panel is "Should the Commission Revise the Accredited Investor Definition," as opposed to "how should it." Whether it should or not, the view of ACA to that question is “No,” certainly as far as the financial thresholds go.

This definition has worked well for decades. There is almost no fraud in angel investing, and to Stan's point, there isn't a problem that needs fixing.

We do believe that sophistication is key to this type of investment, and we would welcome the addition of sophistication criteria that could prudently expand this asset class.

Our top criteria would be members of angel groups that follow best practices.

In order for this sophistication -- because that's another complex question -- who can verify that? -- to be viable, we would suggest a qualifying questionnaire that an investor would fill out, that the issuer could then rely on, and we've submitted a draft or a sample of what that might look like.

So, with that, I'll stop.

MR. HIGGINS: Jean, could I ask a question? I was curious, on the previous experience with the Reg D offerings, you know, the idea about, if you've invested in enough of these, there should be some evidence that, you know, you can fend for yourself, or you have the ability to say no. You know, once burned, twice shy, maybe four or five times, but I have a couple of questions.

What previous experience with the Reg D offerings? Would you be okay, if it was a Reg D offering for which a Form D was filed? What is a Reg D offering, when a form isn't filed is kind of an interesting question.

MR. KELLER: Why does it need to be a Reg D offering?

MR. HIGGINS: That's a good question.

MR. KELLER: You're old enough to remember a time when there was a statutory exemption.

MR. HIGGINS: Indeed. Although, you know, you could have -- you could invest in your brother-in-law's, you know, hot dog stand. Your brother-in-law needs $500 bucks.

MR. KELLER: It would be a food truck.

MR. HIGGINS: Okay. So, that's a private placement.

Does that count? I mean, so what kind of offerings should count for -- and again, it may not be my views, just sparking a little…

MR. KELLER: Well, that's like what degree should count? Is it a degree from the Harvard Business School? Do you have to have majored in entrepreneurship? Do you have to have taken Michael Porter's course and gotten an "A" in it, in entrepreneurship? I mean, I think that becomes difficult.

MR. HIGGINS: How many investments is the right number of investments to establish that base of experience? Any thoughts on that?

MS. PETERS: To your first question, I think we were using Reg D as sort of a proxy term for an exempt offering, but I think, to the question of, is it the $500 in your brother's food truck, that is not, I don't think, what we have in mind.

We're talking about things that come with some sort of offering paper or ultimate issuance of a security, as opposed to, you know, your brother's handshake.

And then in terms of the number of past

experience, if you've done one 506(b) offer, you've probably had to go through a lot. I don't know that you need to do any specific number.

I think the thought is that if you have gone through the experience of, you know, being in this market, you sort of know whether you have a taste for it or not, and whether you're going to do it again.

In terms of portfolio diversification and how you do it well, best practices of angel investing suggests you need a fairly broad portfolio, but in terms of fending for yourself, today, through an accredited platform, you can invest $1,000.

So, why do you need to be a millionaire to invest $1,000 in the exempt market?

You know, so I think even the -- just being able to understand that and invest $1,000 through Angel List -- you shouldn't have to be a millionaire to do that when you can, by the way, invest a much larger amount through crowdfunding if the rules are passed.

MR. KELLER: It's interesting that when the accredited investor definition was originally promulgated, there was an amount of the investment test, in addition to income and wealth, and I always characterized that as, if you really stick to them, it's okay.

But before turning it over to Heath, and picking up -- really tying it in with something Jean said, Don, I think we could all agree information and the gathering of information is important to decision-making and certainly useful, but should we be troubled about the consequences of getting that information?

So, for example, the Reg D proposals requiring the addition of information have consequences for the failure of that, which could impede the very benefits, if you will, of the 506(c) exemption that we now have.

So, for example, to take what Jean said, I would have thought -- given the uncertainties surrounding what's a general solicitation -- as much guidance as we can try to extract, there will always be those uncertainties. I would have thought one of the benefits of 506(c) is to provide the safety net, that even if you don't want to do a, quote, "real" general solicitation, public peddling, you've got the opportunity to comply, to verify, which does tie in, historically, I think, with reasonable belief. Do your 506(b), but have your 506(c) fallback, and if you build in the filing requirements as a condition, you eliminate that benefit.

There are other problems, I think, with the filing requirement about having to update it along the way, about the information that needed to be included in the filing, which create disclosure of confidential information problems and additional burdens.

MR. LANGEVOORT: I sort of mentioned all that quickly. Obviously, you can impose so much in the way of cost on this process that it doesn't become worth the candle, and I'm very sensitive to the confidentiality needs. Obviously, lots of the comments on the Reg D proposal go in that direction.

That said, a minimum level of sunlight or transparency, a base of knowledge that the Commission can draw from is necessary to answer an accredited investor definition meaningfully.

And so, I think, over time, as we're building out a 506(c) world, doing the various other things in the JOBS Act, we need to start to be able to answer questions better about what are these deals? What are they doing? What are they returning to investors? And to me, some minimum level is the cost necessary?

So, we've been talking about tradeoffs. You started with that. To me, that's a tradeoff. Merely identifying, oh, this would be very costly, it may deter people. To me, isn't a good answer.

Managing costs wisely and efficiently is an absolute imperative for the Commission.

MR. KELLER: So, a carefully constructed

information gathering approach that took into account the consequences, you know, like you can get information after the fact that doesn't impede earlier. You can have consequences that don't make subsequent offerings, we'll call it, difficult or impossible to do.

MR. LANGEVOORT: That's right. And you know, my own guess is that the salesman isn't going to disappear from this space, and thus, FINRA's initiatives, to me, become as important as the Reg D proposals in terms of the information and the transparency that can be gathered through what FINRA has been doing for a long time.

MR. KELLER: Heath, is there a state perspective on this?

MR. ABSHURE: Absolutely. And I guess this is the first time I should give a caveat here. I am not an accredited investor even if you use the 1982 standards. So, if Stanley said that accredited investor is a surrogate for sophistication, so maybe you guys shouldn't listen to me anymore, assuming you were to start with.

I think, for the states, we've long supported -- we've long advocated for an adjustment of the accredited investor definition in light of inflation, but I think, more importantly, we've always supported the adoption of a definition that really reflects the sophistication of the investor.

One standard we have proposed in the past is the investments-owned standard. I think, at the time, it was maybe $1 million in investments-owned to qualify to be an accredited investor, and the SEC proposed this back in 2007. But what the states really want is a test that really measures sophistication, but doesn't place an undue verification burden on the issuer.

When you consider the accredited investor standard, we would never allow a broker-dealer or an investment advisor to assume its customer is sophisticated just because it is accredited. In fact, FINRA expressly prohibits it.

You know, an accredited investor standard is not a substitute for suitability, but yet, we turn that assumption on its head when we're talking about what we're doing on the Corp. Fin. side. And I think there's a disconnect there.

So, we do. I think the way we would like to look at it, and going back to what I mentioned earlier, is kind of going back and looking at what are the typical aspects of the type of offerings that we're talking about?

You know, a lot of times, there's -- and this isn't all of them, but -- little or no operational history, illiquidity, very speculative. There's, you know, a high death rate for small businesses.

So, I think we need to go back and look at the -- kind of look at the playing field. What is a private placement? What are the proper requirements for a private placement? What will these companies look like? Who should that investor be?

And, I think there's two aspects there. Who should invest, and who is sufficiently sophisticated to know -- to invest if they want to?

I mean, I think there's one that's almost a financial measure you can make that, if you hit this, yeah, you can invest, but the other is a little bit different. The ability to make that informed decision.

MR. HIGGINS: Let me say, on an administrative note, if you have questions, just as with the prior panel, if you fill out the card and bring them up here, we'll get it, or if you're on the web cast, smallbusiness@SEC.gov will get that question to us.

MR. KELLER: For the panel, Heath, I think, basically teed this up.

How precise does our effort here have to be? Or is it an approximation that basically ends up with the regulators, both state and Federal? Because you're interested at the state level, because if it's 506(c), you're out of the ballgame, except for enforcement after that, on what one might call an approximation of that group of people who are less likely to be the subject of fraud.

MR. ABSHURE: I think almost anything is going to be more precise than what we have now with the net income standard. I mean, how often are you going to go back and take a look at that? Every year?

Once you hit it, are you always -- if it really is a surrogate for sophistication, if you hit it one year, do you remain an accredited investor forever? Well, no, that doesn't make sense if a test is really designed to measure what it's supposed to measure.

I think that, once again, it gets back to what we always talk about in securities regulation, which is balancing.

You balance the veracity of the information you get, the reliability of that information against the cost to the issuer to obtain that information, and you do the best you can.

You know, if we had -- if we have the accredited investor test that really measured sophistication in a workable way -- we've been talking about this for years -- they'd name the building after me, but we just -- we keep struggling and we haven't gotten there yet.

But I think it's time, given the drastic changes to the private market, especially what's potentially going to be brought about by the JOBS Act. This is a fundamental question. The time has come. We've really got to do something.

MR. KELLER: Well, we have the numbers. You can change those numbers, but there is a precision, if you will, to them. It's determinable. It's verifiable.

But to be -- to be specific, the proposal to exclude retirement income, because people aren't managing that -- well, good tax planning says spend all your other money and put as much as you can into the retirement, because it's tax-advantaged. Does that make sense?

MS. PETERS: One CEO I worked for took all of his wealth and did a Roth conversion. What would you do with that? Can we exclude all his assets?

MR. KELLER: If you invest even outside retirement in index funds, does that count, or does that not count, because you're not making investment decisions?

MR. LANGEVOORT: I think all of the -- this is a way of answering your question. I think all of the proposals for refining the definition stumble on definitional questions that are essentially fatal, like the ones you're asking right now.

I think the idea that there's a limit, a percentage of X that you can risk in a certain kind of investment, which, you know, obviously, is the crowdfunding model, is doable. I don't envy setting those numbers, but it is the most objective of all the proposals.

But to go to the bottom line, given that this is an estimation in the first place of -- not a prediction how well will people fend for themselves but how much responsibility should we impose on people to choose for themselves and choose wisely -- a normative question, I would urge -- urge no one at the Commission to seek precision. I think this has to be wisdom and common sense.

MS. PETERS: I just wanted to add, on the question of retirement assets, one of the risks of something like an angel investment is illiquidity. But if you're a 25-year-old, you know, MBA, someone working in finance, who's beginning their process of accumulating retirement assets, you have the biggest liquidity window available, and arguably, these are the types of assets, because you know, they -- they can, over time, provide a higher return than -- than many other investment options, that you should be encouraging in retirement assets.

MR. HIGGINS: Well, that kind of dovetails a little bit with a question we got from the audience.

In Israel, the definition of an accredited investor includes an individual who has subject matter expertise in capital markets or employed at least one year at a professional capacity.

Shouldn't certain qualitative considerations be brought into determining accredited investor status in the U.S.?

MR. ABSHURE: I totally agree. I think all of us out here -- I know some very smart people who are extremely sophisticated that aren't accredited investors, and I know some accredited investors I wouldn't trust with a potato gun, you know, so -- but how do we build -- what is that test?

MR. LANGEVOORT: I agree completely. I think all of those qualitative metrics that have been talked about fail miserably.

When you try to answer the question correctly, does this person have the wherewithal to make these kinds of judgments, you're talking about ability to answer questions, experience, what Jean was talking about, I don't think you can capture that with any degree of accuracy in a test.

I think when we use tests like that, they're often set at a very low threshold, with the desire to maximize the number of people who pass the test rather than to get the test answers right.

MR. ABSHURE: And I would also be concerned about any residual liability for declaring someone, you know, accredited or sophisticated, and then, you know, they suffer a loss and they make a claim that, hey, no, I wasn't. You should have kept me out of that, I wasn't, that test was faulty.

MR. HIGGINS: This is America, after all.

MR. ABSHURE: You still get sued for that.

MR. HIGGINS: Right.

MR. KELLER: I was going to say, Keith, we're going to be looking to you to give us a safe harbor on any -- get a fax of a degree.

MR. HIGGINS: One question just came up.

Does anyone know how the original 1982 financial thresholds were chosen? And was there a comprehensive analysis that somehow, you know, pinned that as the right number at the time? And if so, are we just anchoring -- if we inflate it to current levels, are we just anchoring to something that didn't have any rational basis in the first instance?

MR. KELLER: Well, we know there was no DERA back then.

MR. LANGEVOORT: I don't know the precise answer to the question. Obviously this was a discussion between Congress and the Commission in 1980, where we had legislation using “accredited investor” -- that becomes the platform for the Reg D.

I am sure, without having firsthand knowledge, that there was no DERA-like judgment, that it was a number picked out of the air as a compromise between two very competing positions.

MR. KELLER: But I think it's fair to ask the question, as well, all right, well, that's interesting and curious, but how important is the answer to that question, given the way it's been applied, how it's been used, and what we've seen happen?

MR. LANGEVOORT: When I started teaching accredited investor, Reg D, my students were very much on the side of that can't be right as a way of investor protection.

When I teach it in 2014, it's let's open capital raising, because the young people of America deserve a future.

Depending on which of those you listen to, you pick a number, but it's nothing more than a way of saying it's got to be somewhere in between those two, because people do deserve a future, and capital raising deserves a future.

So, you can't just say, well, let's find the number that best approximates the largest percentage of people who can fend for themselves.

MR. HIGGINS: We're getting close to the end of our time.

Commissioner Stein, any thoughts, question you want to ask of the panel?

MS. STEIN: It's hard for me to comment on this right now, because it's such an active -- I think it's an active discussion across many of the things we're considering right now, you know, at the Commission.

So, it's just extremely helpful -- what I hear repeatedly are the tensions. Every single one of you is talking about the tradeoffs, and maybe from working for the Senate, right, and working here, I agree with you.

At some point, this becomes a decision about how you're going to deal with those tradeoffs, but we are in a new world, and I think, you know, to go back to the Startup Garage, you know, in L.A., people are desperately trying to figure out how to capitalize their good ideas and get what they need to go up to the next level. We need to figure it out.

So, I think this is going to be a continuing dialogue, and a very thoughtful one, and I hope maybe someone today in the breakout panels is going to come up with a solution and hand it to us, but I think we're going to, you know, need to keep thinking about this, and I agree with sort of the way you laid this out, Heath.

We also have this larger issue going on, is what should be a private offering, you know, versus a public offering? And does one have different protections than the other for investors, and what are those? And we also have this issue of how -- is there a difference now between those two -- to go back, it used to be we had a much smaller percentage of offerings being made through private placements, as you were pointing out, Jean, and now we have a rather thriving and robust market doing that, and we -- until recently -- have not had as much insight, you know, into how extensive that market is, how much capital raising is being done, and in what form.

So, I agree, also, with, you know, your comment about, we need more information -- this is a nice DERA point -- we need more information so we can make really thoughtful public policy choices.

So, I think that's one of the things I'm also, you know, hearing.

We're in a new world. We need to evolve. We need to think about how we proceed. But we need to understand, you know, where to make those tradeoffs and why and have a better understanding of, in this case, our private placement, you know, market.

MR. GOMEZ ABERO: Thank you, Commissioner Stein.

Thank you, Keith and Stan, and thank you for the panelists.

At this time, we're going to take a break for lunch and then reconvene at 2:00 o'clock, and we will not be meeting in this room at 2:00 o'clock, but when you come down the stairs, to your left is the multipurpose room.

We will be reconvening in the multipurpose room, and from there, you will be able to go to one of the four breakout panels where you'll be able to start working on recommendations from us.

So, I'll see you at 2:00 o'clock.

Thank you.

(Whereupon, at 12:41 p.m., the meeting was concluded.)

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PROOFREADER'S CERTIFICATE

In The Matter of: 2014 SEC GOVERNMENT-BUSINESS FORUM
ON SMALL BUSINESS CAPITAL FORMATION

File Number: OS-1120

Date: November 20, 2014

Location: Washington, D.C.

This is to certify that I, Nicholas Wagner, (the undersigned), do hereby swear and affirm that the attached proceedings before the U.S. Securities and Exchange Commission were held according to the record and that this is the original, complete, true and accurate transcript that has been compared to the reporting or recording accomplished at the hearing.

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