

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

MEETING OF THE ADVISORY COMMITTEE  
ON SMALL AND EMERGING COMPANIES

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U.S. Securities and Exchange Commission  
100 F Street, N.E., Washington, D.C.

1 PARTICIPANTS:  
 2  
 3 Stephen Graham, Chair  
 4 Sara Hanks, Co-Chair  
 5 Jay Clayton, Co-Chair  
 6 Kara M. Stein  
 7  
 8 Julie Davis  
 9 Amy Edwards  
 10 Sebastian Gomez  
 11 Brian Hahn  
 12 Catherine Mott  
 13 Betsy Murphy  
 14 Michael Pieciak  
 15 Patrick Reardon  
 16 Joseph Shepard  
 17 David Shillman  
 18 Lisa Shimkat  
 19 Annemarie Tierney  
 20 Gregory Yadley  
 21 Laura Yamanaka  
 22  
 23  
 24  
 25

1 PROCEEDINGS  
 2 CO-CHAIR GRAHAM: Okay, welcome, everybody.  
 3 Sebastian, I guess we have a quorum?  
 4 MR. GOMEZ: We do.  
 5 CO-CHAIR GRAHAM: Okay. Our business this  
 6 morning -- we will start with the topic that flows from  
 7 our last meeting, where we discussed the decline in IPOs,  
 8 and the fact that we'd like to see more opportunities for  
 9 small and middle-market companies to raise money in the  
 10 public markets.  
 11 We will hear from two underwriting firms active  
 12 in the smaller offering space, and we thank them for  
 13 coming and welcome their insight as to the challenges and  
 14 opportunities presented.  
 15 We will also get an update from SEC staff on  
 16 the tick size pilot. This committee has been interested  
 17 in widening tick sizes since our tick size recommendation  
 18 in 2013. We look forward to hearing what the data shows  
 19 so far.  
 20 This afternoon Mike Pieciak will update us on  
 21 NASAA's most recent enforcement report. I think it is  
 22 fair to say that the members of this committee, through  
 23 the years, have always had a desire for more data  
 24 relating to the connection between regulation and fraud  
 25 prevention. We look forward to Mike's help in this

1 CONTENTS  
 2 PAGE  
 3 Welcome and Opening Remarks  
 4 Stephen Graham 4  
 5 Jay Clayton 7  
 6  
 7 Underwriting Small Offerings  
 8 Presentation by Robert L. Malin 14  
 9 Presentation by J. Bradford Eichler 57  
 10 Update on Tick Size Pilot Program from Staff in the 94  
 11 SEC's Division of Trading and Markets and  
 12 Division of Economic and Risk Analysis  
 13  
 14 North American Securities Administrators Association 108  
 15 (NASAA) Presentation on its 2016 Enforcement  
 16 Report  
 17  
 18 Consideration of Draft Recommendations on Secondary 146  
 19 Market Liquidity and Broker-Dealer Status of  
 20 Finders  
 21  
 22 Closing Remarks 169  
 23  
 24  
 25

1 regard.  
 2 And finally, we will end this afternoon by  
 3 finalizing two key recommendations having to do with  
 4 finders and secondary liquidity.  
 5 Before we begin the work I just outlined, let  
 6 me say that we're very pleased and honored to have with  
 7 us for one of his first public appearances in his new  
 8 role, Chairman Jay Clayton. Chairman Clayton was sworn  
 9 in on Thursday of last week. Congratulations on that.  
 10 Thank you very much for coming, and we look forward to  
 11 working with you.  
 12 Is Commissioner Stein -- yes. Okay. We also  
 13 have Commissioner Stein with us this morning. And we  
 14 will hear remarks from both of you.  
 15 And is Joe Shepard? Oh, hi, Joe. We also want  
 16 to introduce a new face in the Small Business  
 17 Administration seat today, which is Joe Shepard. He was  
 18 just recently named as the associate administrator for  
 19 the office of investment and innovation. So welcome to  
 20 you, Joe.  
 21 And now I will quickly turn to the division of  
 22 corporation finance. And they are led this morning by  
 23 Deputy Director Shelley Parratt, who is -- who will  
 24 introduce the others, I think.  
 25 MS. PARRATT: Thank you, Steve. I am back to

Page 6

1 being deputy director, and I am very excited about that.  
 2 I love that job. Bill Hinman is starting today. It's  
 3 been a whirlwind week for me with Chairman Clayton and  
 4 the new division director starting in one week.  
 5 I speak for all SEC staff members today when I  
 6 remind you that any remarks made by any staff member,  
 7 including me, reflect his or her own views, and not  
 8 necessarily those of the Commission or any other member  
 9 of the Commission staff.  
 10 I am really excited about your agenda today,  
 11 and I see that you are well set up to continue your  
 12 discussion about reviving or facilitating further  
 13 activity in the markets. I know that I speak for all  
 14 staff members when I say that we really appreciate your  
 15 insight and your views.  
 16 I want to make sure that you know who else is  
 17 up here from CorpFin. Betsy Murphy is one of our  
 18 associate directors, and a long-term member of CorpFin,  
 19 and knows the small business space very well. Sebastian  
 20 Gomez is the head of the small business policy office,  
 21 and I know you all know Sebastian incredibly well. And I  
 22 know that you've gotten to know Julie Davis very well.  
 23 Julie is a senior special counsel in the office of small  
 24 business policy.  
 25 Thank you again for coming, and we look forward

Page 7

1 to hearing your views.  
 2 CO-CHAIR GRAHAM: Okay, thank you. And now  
 3 I would like to turn the mic over to our new chairman.  
 4 So, Chairman Clayton?  
 5 CO-CHAIR CLAYTON: Well, good morning, and thank  
 6 you. Thank you, Steve. Sara, thank you. Welcome, Joe  
 7 and Shelley. Thank you. Thank you for helping me along  
 8 so much. I appreciate it.  
 9 I am grateful to be here, grateful to the  
 10 members of the committee. I recognize that this is a  
 11 volunteer committee, and I want to just thank you for all  
 12 your service and for the opportunity to speak to you  
 13 today. I am pleased that my first public remarks as  
 14 chairman could be to this important group. As these are  
 15 my first public remarks, I think I'd be remiss if I  
 16 didn't start with a few thank-yous.  
 17 So, first, I want to thank President Trump for  
 18 having the confidence in me to nominate me for this  
 19 important position.  
 20 Second, to all those I met during the  
 21 confirmation process -- and it was certainly a new  
 22 process for me, but I know that I'm better prepared for  
 23 this important role as a result of that process.  
 24 And third, and most importantly, to the  
 25 dedicated women and men of the SEC who have made me feel

Page 8

1 at home. It's only been a few days, but I feel very  
 2 comfortable here, and I feel incredibly well supported by  
 3 my fellow commissioners and by the staff. So thank you  
 4 for that.  
 5 Now, to the business of the day. Facilitating  
 6 capital formation is one of the central tenets of the  
 7 SEC's mission, is the focus of this committee, and it is  
 8 one that I share. One of my priorities for the  
 9 Commission is to focus on facilitating capital-raising  
 10 opportunities for all companies, including, and  
 11 importantly, small and medium-sized businesses. Doing so  
 12 will not only help those companies, but it will also  
 13 provide expanded opportunities for investors, help our  
 14 economy grow, facilitate innovation, and further job  
 15 creation.  
 16 As I mentioned during my confirmation hearing,  
 17 I do understand the many challenges facing small and  
 18 medium-sized businesses, as well as the importance of  
 19 those businesses to our local economies and,  
 20 collectively, our national economy. I appreciate your  
 21 willingness to share your knowledge and insights about  
 22 smaller and emerging companies, and the challenges they  
 23 face.  
 24 This committee has already made important  
 25 recommendations that facilitated the ability of small and

Page 9

1 emerging companies to raise capital. The topics on your  
 2 agenda today, including finders, the underwriting of  
 3 small offerings, and the tick size pilot, among others,  
 4 represent discussions that we should be having, and,  
 5 importantly, that I expect will provide a basis for  
 6 action.  
 7 I look forward to your thoughts and any  
 8 recommendations that stem from your deliberations.  
 9 And finally, again, to echo some prior  
 10 comments, this is Public Service Recognition Week, and I  
 11 want to close my remarks with a few words from our town  
 12 hall of yesterday. This agency and this committee is all  
 13 about the people. There are no widgets here, at the SEC.  
 14 It's about smart, caring people analyzing and  
 15 implementing the law in an environment that is  
 16 ever-changing, with the laudable goal of increasing the  
 17 opportunities for all to participate in America's growth.  
 18 With your hard work, you are ably assisting in  
 19 that effort. And thank you.  
 20 CO-CHAIR GRAHAM: Thank you, Mr. Chairman.  
 21 Commissioner Stein?  
 22 COMMISSIONER STEIN: I also want to welcome  
 23 everybody to the meeting today. And, in particular, I  
 24 want to welcome our new chairman, Jay Clayton. Welcome,  
 25 Jay.

<p style="text-align: right;">Page 10</p> <p>1 This advisory committee is dedicated and a  2 thoughtful group. And at each meeting I found they are  3 bringing forth their best ideas about how to support and  4 maintain healthy marketplaces for smaller companies,  5 while maintaining appropriate investor protections. And,  6 like me, I think you will undoubtedly benefit from the  7 committee's discussions of issues that are critical to  8 both small and emerging companies, and to investors.</p> <p>9 Today's agenda will examine the underwriting of  10 smaller offerings, provide updates on the tick size  11 pilot, discuss NASAA's 2016 enforcement report, and  12 consider recommendations on secondary market liquidity  13 and broker-dealer finder status. I think all of these  14 agenda items form part of a larger mosaic, which includes  15 varying perspectives on how best to support access to  16 capital, how to best create economic incentives for  17 intermediaries to either underwrite primary issuances, or  18 to create secondary market liquidity for smaller  19 entities, and how to best protect investors.</p> <p>20 It's been noted that investment follows trust.  21 Investor trust and investor confidence are central to the  22 ability of smaller companies, in particular, to initially  23 raise capital and to continue to access is. And when  24 investors trust the market, they invest again. And they  25 repeat their engagement with the market. Such repeat</p>	<p style="text-align: right;">Page 12</p> <p>1 access for smaller companies, which, as we know, are the  2 engines of growth for our entire economy. And we all  3 share the goal of supporting healthy markets that provide  4 a pathway for companies to grow and investors to engage  5 in our markets. We also all share the goal of  6 safeguarding investors and shoring up investor  7 confidence.</p> <p>8 So, as usual, I look forward to hearing your  9 perspectives on how to best achieve this balance, going  10 forward. Thank you.</p> <p>11 CO-CHAIR GRAHAM: Thank you, Commissioner  12 Stein. I think that does it for the kind of the  13 preliminary part of the meeting. And so we'll move on to  14 the subject of underwriting small offerings. And so I  15 turn it over to my co-chair, Sara.</p> <p>16 CO-CHAIR HANKS: Thanks. At a number of  17 our prior meetings -- and I think it might be all of  18 them -- we've discussed reasons why smaller and mid-sized  19 companies are not accessing the public markets in the  20 numbers that we'd like to see. We discussed the very  21 complicated question of what we -- can we do to help  22 companies who are not either current or potential  23 billion-dollar unicorns, but nonetheless still worthy of  24 finance.</p> <p>25 One recurring theme that we see is there is not</p>
<p style="text-align: right;">Page 11</p> <p>1 engagement benefits all market participants, from the  2 start-up that receives an infusion of initial capital to  3 the investor who can rest assured that there are  4 appropriate investor safeguards in place to help protect  5 them from fraud.</p> <p>6 So, in the meeting today I encourage you how to  7 best reach that balance between the creation of capital  8 formation opportunities for companies, while still  9 maintaining strong investor protections. I look forward  10 to your discussions on the role of intermediaries at both  11 the underwriting stage and -- again, I'm going to  12 emphasize in regards to secondary market liquidity --  13 preliminary data from the tick size pilot may provide all  14 of us with initial insights into the efficacy of wider  15 trading increments, their impact on secondary market  16 liquidity for smaller stocks, and also on the potential  17 cost to investors that may result from wider spreads.  18 This is all part of our, you know, understanding, when we  19 think about policy choices, going forward.</p> <p>20 I, as always, look forward to the NASAA report  21 on enforcement efforts and trends. And to effectively  22 examine and understand the market for smaller companies,  23 again, I think we have to take this holistic view of what  24 we're seeing in a variety of places in the market.</p> <p>25 We all share the goal of facilitating capital</p>	<p style="text-align: right;">Page 13</p> <p>1 currently a robust-enough ecosystem to help facilitate  2 underwriting and ongoing research of small and mid-sized  3 companies. We thought it would be interesting to hear  4 from a couple of broker-dealers who are operating in this  5 space, Reg A and IPO markets. What do they see that's  6 working? What do they see that's not working? Where can  7 we help?</p> <p>8 First, I would like to introduce Brad Eichler,  9 executive vice president and head of investment banking  10 at Stephens Inc., a financial services firm located in  11 Little Rock, Arkansas, my husband's home state. Brad has  12 been with Stephens since 1991, starting as an associate  13 in the firm's research department. He currently oversees  14 the firm's investment banking operations, which has over  15 170 professionals, and 8 offices in the U.S., as well as  16 offices in London and Frankfurt. Earlier in his career,  17 Brad worked at Merrill Lynch Capital Markets.</p> <p>18 Next to Brad is Rob Malin, managing director  19 and head of equity capital markets at W.R. Hambrecht and  20 Co., an investment bank headquartered in San Francisco,  21 with offices in New York. Prior to joining Hambrecht in  22 2016 he spent over 7 years with NASDAQ, most recently as  23 founding member of NASDAQ private market. Rob spent five  24 years at Liquidnet, including heading the firm's equity  25 capital markets business. He began his financial</p>

1 services career working for Credit Suisse, Barclays, and  
2 Lehman Brothers.

3 We are very appreciative to have both of you  
4 here today to share your experiences and help us delve  
5 further into this very important topic. Please go ahead.

6 Brad, are you going first? Rob is going first.  
7 All right, thank you.

8 MR. MALIN: Good morning, and thank you very  
9 much for having me. To the committee, the chairs,  
10 members of the division of corporate finance, and thanks  
11 very much, Mr. Chairman, for attending and sharing your  
12 insights here. And Bill Hambrecht was in the New York  
13 offices yesterday, so I had the opportunity to see him.  
14 And he asked me to extend his personal gratitude to  
15 Commissioner Stein, who he said was instrumental in  
16 helping drive forward the Reg A, you know, regulations,  
17 and really did express sincere appreciation for all that  
18 you've done to help in this marketplace.

19 So, with that, I will try to keep my comments  
20 relatively brief here. But I think it is important, as  
21 an underwriter who is focused on Reg A underwritings, to  
22 describe some of our experiences since the rules were  
23 adopted. W.R. Hambrecht has engaged somewhere between  
24 200 and 250 small and emerging companies who have  
25 expressed interest in pursuing growth capital in the

1 public markets via Reg A. And our experiences have been  
2 varied.

3 We take pride in those companies that we have  
4 vetted and brought to the markets. We are certainly  
5 disappointed that there haven't been more successes, but  
6 I am happy to share as honestly as I can our experiences  
7 with each of those representative companies that I've  
8 included in my presentation, and hopefully that will  
9 provide some insight on what can be done to further  
10 support this market and perhaps improve the odds that  
11 more of these companies have success in finding capital  
12 in the public markets.

13 So I thought it was appropriate to begin my  
14 remarks with a quote from W.R. Hambrecht's founder, Bill  
15 Hambrecht. The philosophy of this firm is driven largely  
16 by his work, and he has said on many occasions -- this  
17 happens to be a quote from a Forbes articles -- "I want  
18 to challenge entrepreneurs to revolutionize the new issue  
19 process, urging them to come public early, and let the  
20 public participate." And I think that was probably a  
21 remark made around W.R. Hambrecht's efforts in the open  
22 IPO market, which is an effort to democratize  
23 participation in IPOs and drive, really, market pricing  
24 for IPOs.

25 But it is equally applicable for what we're

1 trying to accomplish in these Reg A+ offerings, where we  
2 believe that a large community of investors across the  
3 spectrum, from large institutions to small individual  
4 investors, will drive success for these companies that  
5 are seeking growth capital for their early-stage capital  
6 formation.

7 And I should also say that quote helps to  
8 answer one of the initial questions that Julie asked us  
9 to address, which is why are we in this Reg A+ business.  
10 So I think there is a bit about W.R. Hambrecht and his  
11 heritage that makes it very natural that we would be  
12 interested in driving innovation and capital formation,  
13 that we would be interested in pursuing a new and  
14 different type of capital-raising mechanism to offer that  
15 to private companies.

16 So, very brief outline of where my remarks will  
17 go this morning, I will give a little bit of background  
18 on Hambrecht itself, its heritage and its culture,  
19 discuss a little bit about our selection process for  
20 those companies that we determine appropriate to bring to  
21 the marketplace for investment by that broad community of  
22 investors. And then, I think the bulk of my remarks will  
23 revolve around our experience in bringing, as I have  
24 said, some representative companies to the marketplace.  
25 Each of those have reached a particular stage of

1 completion. Not all have closed their transactions. But  
2 each has been reviewed by the SEC, and in many cases have  
3 gone all the way through qualification of their offering,  
4 and we can share those experiences.

5 And, most importantly, then I will follow up  
6 that review of each of those experiences with what we  
7 believe we have learned. And, of course, as one of my  
8 colleagues put it recently, I think we have learned quite  
9 enough now. We would like to have some more successes  
10 and earn our fees, quite frankly, you know, to have some  
11 of these transactions completed and into the market, and  
12 have them trading for the public.

13 And then finally, some recommendations that may  
14 be helpful. I think they are very broad recommendations,  
15 in my view. But again, driven from those things that we  
16 feel we have learned over the course of trying to bring  
17 several of these transactions to market, what we think  
18 may be able to help.

19 So, a little bit about W.R. Hambrecht's  
20 heritage. W.R. Hambrecht -- and Hambrecht and Quist  
21 before that -- have consistently identified new trends in  
22 the marketplace, identified opportunities for companies,  
23 particularly those smaller and emerging companies, to  
24 access growth capital outside of the traditional private  
25 market. So Bill has always been a believer, and the firm

1 has always advocated that the public markets are an  
 2 appropriate place to seek growth capital.  
 3 And what we've seen over the years is there are  
 4 many now-large companies who successfully access growth  
 5 capital early in their life cycles. Some examples on  
 6 this page: Apple, Adobi, and Genentech, that were able  
 7 to finance their early growth in the public market, and  
 8 do that very successfully. And, while that was,  
 9 obviously, rewarding for those companies, it was also  
 10 rewarding for their shareholders.  
 11 As you all are aware, our founder, Bill  
 12 Hambrecht, was very involved in the construction of the  
 13 revised Reg A and worked, as I've mentioned, closely with  
 14 Commissioner Stein. And, as a result, was quoted  
 15 throughout the -- releasing the final rule.  
 16 So, a little bit further about W.R. Hambrecht's  
 17 guiding principles. The idea has been to follow three  
 18 tenets.  
 19 First, identify exceptional companies. We  
 20 understand that, particularly in the public markets, the  
 21 key to winning financing is to be an exceptional company.  
 22 We endeavor to identify those companies early, to help  
 23 them market themselves appropriately to a broad investor  
 24 community, and to vet them to a degree that ensures that  
 25 investor trust and comfort with the deals that we bring

1 to market.  
 2 Certainly these companies are often times  
 3 younger, less-developed companies than many of the  
 4 unicorns that are, you know, perhaps most successful in  
 5 the public markets today. But I think they are no less  
 6 interesting, no less valid, in terms of garnering  
 7 investment capital, and certainly can be much more  
 8 rewarding for the investors that get in at a very early  
 9 stage.  
 10 W.R. Hambrecht has also been focused throughout  
 11 its life on delivering efficient market pricing. So  
 12 that's reflected in the offering of the open IPO process,  
 13 a patented process that Hambrecht has offered many  
 14 companies. In my view, that's been embraced mostly by  
 15 mavericks. So those CEOs that are willing to do  
 16 something dramatically different with their offering have  
 17 been willing to risk doing something a bit out of the  
 18 ordinary for an initial public offering.  
 19 I was interested to hear a small company CEO  
 20 say that many view their IPOs like their daughter's  
 21 wedding. So you want to do everything you can to ensure  
 22 that you don't screw it up. So the idea of stepping  
 23 outside of a traditional process to pursue something that  
 24 you believe has benefit for investors, for the issuer, is  
 25 interesting and exciting. But the fact is that there is

1 a great deal of trepidation on the part of these company  
 2 leaders to do something a little bit outside of the  
 3 ordinary.  
 4 Nonetheless, we will continue to pursue that,  
 5 and hope to find those mavericks from time to time. And,  
 6 you know, by delivering this more efficient market  
 7 pricing, we hope to deliver better results for both  
 8 issuers and investors, of course.  
 9 So a little bit more about the changes that  
 10 we've seen in the marketplace. And this feels like  
 11 ancient history, when you go back to Adobe's IPO in 1986.  
 12 But it's a good example of a company that raised a small  
 13 amount of money early in its lifecycle and financed  
 14 tremendous future growth. So the equivalent -- Adobe's  
 15 capital raise in 1986 was the equivalent of \$13 million  
 16 today. And at the time they had fewer than 50 employees.  
 17 So that allowed that company to grow. As of February  
 18 this year, when we put this slide together, they -- the  
 19 market cap was over 59 billion, revenues in 2016 of 5.8  
 20 billion, and now over 15,000 employees.  
 21 So, as you can see, that early growth capital  
 22 was a critical component in allowing Adobe to grow. And  
 23 what I found most interesting about our review of what's  
 24 changed in the past is that Adobe was not alone, by a  
 25 long shot, in terms of companies that have grown to be

1 massive companies that started off with a small capital  
 2 raise. So I've listed on the right-hand side of the  
 3 slide here several companies that raised less than 50  
 4 million in their IPO -- Starbucks, AOL, Pete's Coffee,  
 5 Whole Foods, Panera Bread, Odwalla, Intel, Amgen, Oracle,  
 6 and Cisco. So this wasn't an outlier, in that it raised  
 7 a small amount of capital initially to grow very large.  
 8 So just a word about W.R. Hambrecht's selection  
 9 process for companies that we believe should be financed  
 10 in the public markets. We take this very, very  
 11 seriously. We believe it's our obligation to select and  
 12 vet these companies and bring them to the public markets  
 13 as companies that are deserving of public investment  
 14 dollars. We utilize a data-driven process. So, separate  
 15 and apart from all of our traditional analyses of these  
 16 companies that we speak to and engage, particularly in  
 17 discussions about Reg A+, we will put through what we  
 18 call a disruption screen.  
 19 So, since its founding in 1988, Clayton  
 20 Christensen, the author of "The Innovator's Dilemma,"  
 21 and, really, the coiner of the term "disruptive  
 22 innovation," has been involved with W.R. Hambrecht, and  
 23 we've utilized his ideas and his research to drive our  
 24 selection of companies that we believe have the potential  
 25 to disrupt industries and be outstanding public

1 companies. Bill Hambrecht and his team, on the venture  
2 capital side of our firm, have applied these processes in  
3 many situations. We show here over 3,000 real-world  
4 predictions to increase the chances that they will invest  
5 in companies that grow successfully.

6 So there is no guarantees, of course, in life  
7 that companies will be successful. But by utilizing this  
8 data-driven selection process, we hope to increase the  
9 odds that the companies that we bring will turn out to be  
10 rewarding investments in the public markets.

11 Okay, so that's really the background on our  
12 firm, why we've determined that Reg A+ is an area where  
13 we think it's appropriate that we play. W.R. Hambrecht  
14 has been one of the very few underwriting firms that has  
15 planted a stake in this new regulatory framework and said  
16 that we will work with companies to help them bring their  
17 companies public via Reg A. And we will continue to do  
18 that.

19 There have been, as we've mentioned -- and, I  
20 think as the committee all understands, limited success  
21 to date. But there are numbers of companies in the  
22 pipeline. There is no shortage of companies that have  
23 expressed strong interest in pursuing this particular  
24 type of fundraising. They understand the tradeoffs  
25 between disclosure, public scrutiny of their company, the

1 time and money that must be invested to complete this  
2 process, and they continue to believe that this is  
3 appropriate for them.

4 So, just a little bit of a review of where we  
5 stand to date. Most of these statistics are taken from  
6 the Commission's own report, I think published early this  
7 year. And I believe it reflects statistics through the  
8 third quarter of last year. So some of these numbers may  
9 not be absolutely accurate and up to date, but we know  
10 that there has been more than 140 of these offerings  
11 filed seeking to raise -- getting close, I believe now,  
12 to \$3 billion. Fourteen have been withdrawn. And you  
13 know, a large number of those 140 -- I believe it's well  
14 over half -- have been qualified.

15 And Elio Motors stands alone as the single Reg  
16 A+ deal that is actively quoted on the OTC QX market.  
17 And we will review a little bit more about that when I  
18 get to our case studies. But it is interesting that it  
19 stands alone, and there are some specific things that I  
20 think are perhaps unusual, unique, certainly, about the  
21 Elio Motors transaction.

22 We've seen the largest raise be for an eREIT by  
23 Fundrise at the maximum for Reg A at 50 million. There  
24 have been many who have sought to raise up to that, and  
25 have not yet succeeded.

1 And then our last point here, the idea that the  
2 crowdsourcing, crowdfunding component of Reg A+ continues  
3 to evolve. So there have been many attempts to engage a  
4 broad investment community, including those who may or  
5 may not have active brokerage accounts, may have never  
6 transacted in a securities transaction before in their  
7 life. But I think we continue to see developments in how  
8 companies can engage their communities of fans,  
9 enthusiasts, their affinity groups, and I think that will  
10 be a component of Reg A+, going forward.

11 All of that said, we do find ourselves having  
12 to address a very common misconception in the  
13 marketplace, is that all Reg A capital raising is  
14 crowdfunding, or includes a component of crowdfunding.  
15 And we have spoken to many companies who have found that  
16 Reg A would be beneficial and appropriate for them, and  
17 they are not interested in a broad crowdfunding effort.  
18 And I think it is important to understand that  
19 crowdfunding can be a critical component of these  
20 offerings, and Reg A does a great job in providing  
21 flexibility for companies that wish to pursue that.

22 But there is certainly no obligation on the  
23 part of these companies to engage in any crowdfunding  
24 effort as part of their Reg A offering. And I think it's  
25 on the part of investors, particularly large,

1 institutional investors -- often times they will view a  
2 Reg A offering as inappropriate for them if they believe  
3 it's a crowdfunding effort. So, again, just some  
4 misconceptions in the marketplace, some fairly widely  
5 held misconceptions that we continue to try to address to  
6 make clear that Reg A+, as regulatory framework, does not  
7 mandate that there is either a crowdfunding effort --  
8 crowdfunding component to that effort.

9 So a little bit about W.R. Hambrecht's  
10 distribution strategy for these transactions. And I  
11 think it's important to lay this out in advance of  
12 discussion of our case studies because, for any  
13 particular transaction, we will emphasize one community  
14 of investor participants, perhaps, over another. Often  
15 times we will seek to market to all of them. But, as we  
16 view the world, the top of the pyramid there is the  
17 institutional investor community, those sophisticated  
18 professional investors who often times will drive  
19 valuation for a public offering.

20 The second tier, and what we believe is the  
21 critically important tier for some of these smaller  
22 offerings is that network of independent broker-dealers.  
23 Those broker-dealers represent individual investors that  
24 perhaps range from ultra-high net worth to regular old  
25 mom-and-pop, but also might include smaller hedge funds,

1 small family offices, in some cases larger family  
2 offices.

3 But the important differentiation between the  
4 investors that those independent broker-dealers serve is  
5 that those are people that have a brokerage account  
6 that's open, they are seeking investment. Often times  
7 these investors and the brokers that serve them are  
8 thirsty for product that's appropriate for them. And  
9 they are able to act efficiently and respond to the  
10 appearance of an offering that meets their investment  
11 criteria.

12 And the final -- the bottom of the pyramid  
13 there is that crowdfunding community. And, as I've  
14 alluded to earlier, this is a fascinating group to try  
15 and engage for many companies. Many companies have a  
16 very natural affinity -- community, or they appeal to a  
17 broad community of individuals, whether they are seasoned  
18 investors or not. And so, the potential to bring in  
19 fans, interested parties to a securities offering for a  
20 particular company is one that we embrace, and we think  
21 is extremely exciting.

22 But there are challenges. In many cases, these  
23 fans, these communities of interested parties, will not  
24 be regular investors, will not hold a brokerage account,  
25 may not want to hold a brokerage account, but still have

1 were, to some degree, invested in Elio in advance. So  
2 that may speak to some of their success in converting  
3 their fans and their enthusiasts to become investors in  
4 their company, to the extent that these were really --  
5 these people were invested in the company's future  
6 already, in that they wanted to own an Elio vehicle, and  
7 they put down money as a pre-order there.

8 But I think you can see that at \$12 a share,  
9 and 200 shares was the average order, so just \$2,400,  
10 these were small investors. And, incredibly, they  
11 rounded up enough of those small investors to raise  
12 meaningful capital -- so 16.7 million, which, you know,  
13 certainly we would view as a success, in terms of  
14 driving, you know, meaningful participation from a broad  
15 community of investors, and raising meaningful dollars  
16 here.

17 W.R. Hambrecht's participation with Elio was  
18 limited, really, to the secondary trading component. So,  
19 upon the close of their offering, they sought to have  
20 their shares quoted on the OTC QX market, and Hambrecht  
21 assisted in getting DTC eligibility and applying for  
22 permission to quote their shares via 15c2-11, and we did  
23 serve as their first market-maker on the OTC QX.

24 So, it's a -- it was an unusual role for  
25 Hambrecht to play there. And our experience there was --

1 an interest in investing in these companies, and  
2 participating in their success and their growth.

3 So, to be able to facilitate their investment  
4 has been something that is, quite frankly -- I think has  
5 been done very well, to date. And again, thanks to the  
6 regulatory framework that was established, that is a  
7 possibility. So it -- that works from time to time. Not  
8 always, but that's a great aspect of this new regulation.

9 So, on to a few of the specific case studies.  
10 So, first, I will take the most obvious. So Elio  
11 Motors -- and I am sure that everybody has studied this  
12 case study more than they'd like to, and it's been spoken  
13 about time and time again as the single success here in  
14 the Reg A+ market, but I think there are many things that  
15 are highly unusual about this particular transaction.

16 So it was a self-sponsored, self-marketed  
17 offering. Elio did not choose to engage an underwriter  
18 or pursue any broker-dealer support in bringing their  
19 deal to market. And what was fascinating is they were  
20 able to generate a massive community of interested  
21 investors. And so, 6,300 investors all plunked down  
22 money, took their wallets out of their pockets, and  
23 responded to Elio's outreach on this offering.

24 Interestingly, 60 percent of those that participated were  
25 already reservation holders for this vehicle. So they

1 as, really, the first -- that there were lots of spots  
2 that were uncharted territory. And, as you can imagine,  
3 the process was slower than we would have typically  
4 expected, given that regulators, brokers, issuer were all  
5 new to this process. And it was truly uncharted ground.  
6 That said, that all works. Elio trades today on the OTC  
7 QX. People own those shares in their brokerage accounts,  
8 and can trade them as they wish.

9 So I think that's an important aspect here,  
10 particularly as I continue my remarks. We will see that  
11 there is some concern that OTC QX or other unlisted --  
12 and by unlisted, I mean anything that's not listed on the  
13 NYC or NASDAQ -- are not appropriate investments for  
14 some, because they can't hold them in brokerage accounts,  
15 or can't trade them with ease. So I think that's  
16 something you will hear me say again.

17 So, if we advance here -- so about the time  
18 that Elio was completing its Reg A+ offering, W.R.  
19 Hambrecht was working with a company by the name of  
20 Hyperion. It's a biotech company. As our first Reg A  
21 offering, we sought to deliver to the market an offering  
22 that looked and felt as much like a traditional IPO as it  
23 could under Reg A. So we structured this transaction to  
24 reflect what looked like a conventional registered  
25 offering, so that it was an all-or-none type of structure



1 with a price range. As you can see, the 3.1 million  
2 shares offered, so raising between approximately 25 -- or  
3 20 and \$30 million. And the express outcome there was to  
4 list those shares on the NASDAQ.

5 So, we undertook a very traditional,  
6 institutional marketing effort, and also engaged that  
7 network of independent broker-dealers to deliver retail  
8 demand. The experience there was interesting in that,  
9 again, being early, the institutional community had a  
10 lack of familiarity with Reg A+. Many sought to confirm  
11 with their internal compliance whether they were able to  
12 participate in an offering that was going to be delivered  
13 under Reg A+, as opposed to a fully-registered offering.  
14 That was interesting, especially because the disclosure,  
15 given that they were targeting a NASDAQ listing, was  
16 virtually equivalent to what it would be in an S-1. And  
17 the ongoing disclosure would be governed by the exchange,  
18 so that it would be identical to any other listed  
19 company. But still, there was some hesitation on the  
20 part of the institutions in understanding exactly what  
21 the securities they were purchasing would be under Reg  
22 A+.

23 The education process took some time, and there  
24 was some institutional interest that was uncovered late  
25 in that marketing process. But really, unfortunately,

1 too late to really drive the transaction to success. And  
2 so, we never reached what we determined was going to be a  
3 successful offering, did not meet the minimum number of  
4 shares there, and so never pursued qualification.

5 Yes?

6 MR. REARDON: Was NASDAQ signed on at the time  
7 you did the offering, that if it was -- I guess these are  
8 all best efforts, right?

9 MR. MALIN: That's correct.

10 MR. REARDON: That if -- and you might explain,  
11 because some of these people might not know what a best  
12 efforts versus -- I don't think you'd do a firm  
13 commitment offering on this, would you?

14 MR. MALIN: W.R. Hambrecht doesn't do any firm  
15 commitments. We do all of our own underwritings on a  
16 best efforts basis.

17 MR. REARDON: Okay. But NASDAQ said if you  
18 were able to do a best efforts, that you would be listed,  
19 so that -- is that correct?

20 MR. MALIN: Yeah. It was before my time at  
21 W.R. Hambrecht, but I believe they had received  
22 qualification from NASDAQ. So I don't want to be quoted  
23 on that, because I'm not certain that that's the case,  
24 but I believe that was the case. And so we can go back  
25 and research that. But I believe that was, indeed, the

1 case.

2 Any other questions?

3 (No response.)

4 MR. MALIN: Okay. So we will continue on. So  
5 that was a first attempt -- again, you know, the  
6 intention there was to really emulate the look and feel  
7 of a traditional offering. And that was, you know,  
8 unfortunate that that didn't make it to the final pricing  
9 and listing on NASDAQ. But these things happen.

10 So we then had an opportunity to work not long  
11 after with a different type of company that had a  
12 different philosophy on how they would utilize Reg A+ to  
13 bring their deal to market. There was a commitment on  
14 the part of the company to do a very broad and extensive  
15 marketing effort, and engage the crowd and engage a broad  
16 retail community for investment in this real estate  
17 technology. They had seen several other real estate  
18 offerings succeed, and they thought that this real estate  
19 technology, sort of adjacent industry, could be something  
20 that energized the crowd and drove participation from a  
21 broad community in the crowd.

22 So, they understood that meaningful marketing  
23 was going to be required, and they undertook that and  
24 devoted money to that marketing effort. They determined  
25 a minimum-maximum offering, minimum of 15 million, and

1 had targeted listing on the OTC QX. The results there  
2 were less than expected, certainly.

3 First of all, the fact that they chose a  
4 minimum offering size of 15 million to be generated just  
5 from the retail and crowd communities may have been a  
6 little aggressive. That was a fairly high bar for them  
7 to meet. I think they were perhaps reacting to Elio's  
8 success, in seeing that there was meaningful capital  
9 raised there from, effectively, a crowd effort. But  
10 what we saw here, which we didn't encounter in the  
11 Hyperion offer, was that that network of independent  
12 broker-dealers declined to participate. And the reason  
13 for that was that they viewed this as an unlisted  
14 offering, so one that would not be NYSE or NASDAQ listed,  
15 fell into their unlisted bucket. And, typically, those  
16 brokers' compliance officers either had onerous terms for  
17 those brokers to pursue sale of an unlisted security, or  
18 they forbid it entirely.

19 And so, where we rely typically on a broad  
20 community of those independent broker-dealers to provide  
21 distribution to the retail community, they declined to  
22 participate here, so -- which left Hyperion, really,  
23 with only the crowd to drive investment in this offering.  
24 And that, unfortunately, never yielded the minimum of 15  
25 million. So did not reach that minimum, could not have

1 their first close, and didn't pursue the offering.  
 2 MR. YADLEY: Rob?  
 3 MR. MALIN: Yes?  
 4 MR. YADLEY: Do you have a view as to how much  
 5 of that was -- that's what our process and guidelines  
 6 require, in terms of NASDAQ or not -- binary -- and true  
 7 concerns about liquidity. I mean was there a way to  
 8 bridge that, moving to the non-NASDAQ NYSE bucket to  
 9 another place, but still getting most of the advantages  
 10 of a marketplace?  
 11 MR. MALIN: We hear the concerns regarding  
 12 liquidity must less frequently than the concerns around a  
 13 high degree of scrutiny in any involvement in unlisted  
 14 securities. So, again, I think that's partly driven by  
 15 the conservative nature of compliance officers at  
 16 broker-dealers, but it's also perhaps driven by the fact  
 17 that there hasn't been specific guidance provided by  
 18 FINRA for those compliance officers to be able to follow  
 19 a process for pursuing these.  
 20 So, we understand that, yes, often times people  
 21 will be concerned that there won't be adequate liquidity  
 22 for transactions like Allegiancy, where it was  
 23 potentially going to be as large as a \$30 million  
 24 offering. I think liquidity concerns were less. But I  
 25 can -- I do believe that that is a consideration. It

1 seems to be less a consideration on the individual broker  
 2 side. So those individual brokers, quite frankly, are --  
 3 as I've said, are hungry for product. We'd like to  
 4 present these opportunities to their clients, their  
 5 investors.  
 6 MR. YADLEY: So, not to put words in your  
 7 mouth, but a little more comfort from FINRA or the  
 8 Commission that this is not imprudent to go into a  
 9 non-NASDAQ/non-NYSE ecosystem.  
 10 MR. MALIN: Absolutely. I think that's exactly  
 11 right.  
 12 CO-CHAIR GRAHAM: So are you suggesting  
 13 that there seems to be -- that the greater issue seems to  
 14 be compliance, and then -- and certainty with respect to  
 15 compliance, as opposed to liquidity? And -- or is it --  
 16 does compliance because a greater issue because of the  
 17 absence of liquidity?  
 18 MR. MALIN: I think, again, viewing it through  
 19 the lens of a primary market offering, when we speak to  
 20 dealers about distributing a new issue, it's typically a  
 21 discussion around the compliance side and less about the  
 22 liquidity.  
 23 So, certainly, liquidity will be a component  
 24 that they consider. But if they believe that this is a  
 25 quality investment, and they have investors -- and, in

1 many cases, those investors are people that might  
 2 consider private offerings, and are less concerned around  
 3 liquidity.  
 4 So, given that these brokers can communicate  
 5 with investors that probably have a range of interest in  
 6 liquidity, they believe that they can find appropriate  
 7 homes for less liquid securities.  
 8 CO-CHAIR GRAHAM: And I'm guessing that  
 9 it's like most things, one size doesn't fit all, and it's  
 10 likely to depend on the character of the investors and  
 11 the character of the company.  
 12 MR. MALIN: I think that's exactly right.  
 13 CO-CHAIR GRAHAM: Okay.  
 14 MR. MALIN: So we will continue on. Yet  
 15 another case study here. And I -- again, I think it is  
 16 important to run through a few of these, just because  
 17 they all are different, and they all hopefully highlight  
 18 some of the challenges and the issues that we faced.  
 19 So, coming off of Allegiancy, which, by the  
 20 way, was a B-to-B company. And so, you know, despite  
 21 their efforts to market that broadly, perhaps the appeal  
 22 was somewhat less than it might be for a B-to-C company.  
 23 And so, BeautyKind offered us that opportunity to test  
 24 that. And what we saw here was a company that had strong  
 25 retail recognition, had a very, very strong B-to-C

1 marketing component, particularly because they -- the way  
 2 that BeautyKind works is you buy your high-end cosmetics,  
 3 and those cosmetics companies then donate a portion of  
 4 their profits to a charity of your choice. So very --  
 5 you know, certainly something that could energize a broad  
 6 community of investors here, and again, you know, on a  
 7 kind of a fan and enthusiast basis.  
 8 So, we designed this offering with that concern  
 9 around meeting the minimum in mind. So designated a  
 10 smaller minimum, a min-max offering of 5 to 10 million.  
 11 And again, intended to quote those shares on the OTC QX.  
 12 We did find a small number of our broker partners who  
 13 were willing to participate. They did the work to go  
 14 through the compliance to work on this offering. And  
 15 what I would say the largest lesson from this effort was  
 16 that, while we had very high hopes for the crowd  
 17 participation, it proved highly unpredictable. So,  
 18 unlike Elio, who was able to convert many of their  
 19 interested crowd participants, BeautyKind did not see  
 20 that same success.  
 21 Yes?  
 22 MR. REARDON: You don't have to answer this  
 23 question if you don't want to. Is FINRA hostile to these  
 24 deals?  
 25 (Laughter.)

1 MR. MALIN: Yeah, that -- probably stronger  
2 wording than I would use. Again, I think that the  
3 challenge is that these -- many of these brokers see an  
4 opportunity to participate, but they don't feel  
5 comfortable in doing that, for fear that FINRA was  
6 scrutinize their participation, and that they may be  
7 outside of what FINRA feels is appropriate.

8 So again, in -- with the lack of clarify and  
9 guidelines for participation in these deals, I think  
10 brokers declined to participate.

11 MR. REARDON: I don't want to get off in the  
12 weeds. Could I ask you one other question? Briefly,  
13 and -- but I think it would be useful, because there are  
14 practitioners here, including myself. What are some of  
15 the screening things that you do with respect to these  
16 companies that are important keys? I mean, and obviously  
17 what you guys call hair on companies, and -- but I think,  
18 just briefly, the kind of problems that you're looking  
19 not to see.

20 MR. MALIN: Right.

21 MR. REARDON: Could you just briefly touch on  
22 those? I think that's useful in this context, because  
23 practitioners have a problem getting companies, some of  
24 these smaller companies, to -- you got to keep minutes,  
25 and you can't do a deal with your brother-in-law, and

1 that kind of stuff. But, I mean, coming from you it's --  
2 if that's a real-life filter, that has some credibility.

3 MR. MALIN: Yeah. So I guess my answer would  
4 be we conduct what I think is very traditional due  
5 diligence for all of our underwritings. So underwriters'  
6 counsel, and the underwriters themselves will do, you  
7 know, a collection of all those documents, and a review  
8 of all those documents that we typically do. We will  
9 engage in a site visit and often times many, many  
10 conversations with management before we will engage on an  
11 offering.

12 There is also this component that W.R.  
13 Hambrecht exclusively uses, which is this disruption  
14 screen that we think is valuable, in terms of vetting and  
15 offering, in terms of its potential success. But I don't  
16 know if I can enumerate exactly the -- you know, the  
17 items that we're ticking off on our diligence list. But  
18 it's long. And, quite frankly, you know, by the time we  
19 are marketing these offerings, we feel very intimate with  
20 these companies, in understanding all that they've done  
21 to prepare for an offering.

22 I don't know, is that an adequate answer for  
23 your question? I -- okay.

24 MS. YAMANAKA: Rob, I have a question on the --  
25 just the participation question and the comparison

1 between BeautyKind and Elio. So hindsight is obviously  
2 20/20 on this.

3 MR. MALIN: Right.

4 MS. YAMANAKA: Right? But when you went into  
5 the BeautyKind deal, was there a view that crowd  
6 participation was one mass, homogeneous entity, or was it  
7 really understood -- like you identified in the Elio  
8 example that 60 percent plopped down reservation money.

9 MR. MALIN: Yeah.

10 MS. YAMANAKA: And so probably were screened  
11 out, okay, or screened in. Because I doubt, if that was  
12 the average purchase on a BeautyKind. Right?

13 MR. MALIN: Yeah, that's right. And I think --  
14 so BeautyKind markets their product via the Internet. So  
15 they obviously had a large community of people that they  
16 could reach out to. People buying beauty products were  
17 clearly not people that were also interested in investing  
18 in a company selling beauty products.

19 So they started with a vetted list of  
20 interested parties, but I think we've seen this now time  
21 and time again, where companies -- there is a massive  
22 chasm between those people that will either purchase a  
23 company's products or consume a company's products, often  
24 times for free, and those that will actually get off  
25 their wallet and make an investment. So I think

1 that's -- there -- it will be interesting to see how  
2 marketers begin to parse that crowd to understand which  
3 of those is likely to move on an investment.

4 MS. YAMANAKA: So do you think that was the --  
5 lack of understanding of your -- where they thought they  
6 were going to get their investors from was the greater  
7 contributor, or --

8 MR. MALIN: I think -- the way we advise  
9 companies typically is that if you can include a  
10 component of crowdfunding in your offering, that's great.  
11 And -- but we advise them not to rely on it. So we'd be  
12 much more comfortable -- BeautyKind, for example, saying,  
13 "We think you can raise your minimum if we can engage a  
14 meaningful community of our network of independent  
15 brokers." That's where we think, you know, we can get --  
16 have a view towards what can be accomplished.

17 MS. YAMANAKA: Lesson learned. Thank you.  
18 This feedback is extremely helpful, and I'm really  
19 learning a lot from the case studies. And I'm kind of  
20 putting on my broker-dealer hat for a second. I wanted  
21 to go back to your comment that it would be helpful to  
22 this market if FINRA put out more guidance. But I  
23 would -- kind of want to dig into that a little bit.

24 So, when you say that, like, what guidance do  
25 you think FINRA needs to put out? Is it with respect to

1 doing suitability on retail investors for, like, highly  
2 illiquid investments? Or is it more on diligence,  
3 suitability as an overall thing before they market or  
4 recommend? Or is it something else? I'd love to know,  
5 like, what you think would be particularly helpful.

6 And I'd also like to know what do you think the  
7 issues are for the compliance offices in these  
8 institutional investors? And also the -- your  
9 broker-dealer network, now that Reg A+ is, you know, a  
10 year-and-a-half out, or almost two years out from where  
11 we were when we started.

12 MR. MALIN: Yeah, those are difficult questions  
13 to answer.

14 MS. YAMANAKA: Yeah, I'm sure.

15 MR. MALIN: So I think -- you know, again, and  
16 I'm getting my information somewhat secondhand from the  
17 partner brokers that I speak with who say my compliance  
18 guys say yea or nay. But, as I've mentioned, I think  
19 guidance on where they can participate and have an  
20 understanding -- I guess -- let me see if I can summarize  
21 it.

22 When I think about a Reg A+ offering that has  
23 been reviewed by the SEC -- so, by the way, we've only  
24 done tier twos, and we'll likely continue to be tier two.  
25 But for those offerings that are reviewed by the SEC,

1 reviewed by an underwriter, in many cases they will seek  
2 to be DTC-eligible upon the close of the offering. They  
3 will seek to be quoted and traded on an organized market,  
4 like OTC QX. By virtue of being a Reg A+ tier two they  
5 are required to have a registered transfer agent.

6 To me, all those things address a lot of the  
7 concerns that should cause hesitation among a compliance  
8 officer. And they don't seem to get that far. There is  
9 not a recognition that these are all the things that  
10 credential a Reg A+ issuer in the marketplace. So  
11 perhaps if there were standards, you know, where FINRA  
12 said, "Well, check those boxes," you know, "Is this going  
13 to be quoted and traded on in an organized market? Does  
14 it make a difference if it's going to be a book-entry  
15 security versus physical certificates," you know, is  
16 there -- are there things that mitigate the risk of being  
17 involved in an offering, really minimize the risk that  
18 you're becoming involved in a fraudulent offering of  
19 securities?

20 And I think Reg A has done lots to provide  
21 companies the ability to evidence that they have done  
22 that. But there just doesn't seem to be a recognition of  
23 that. And again, perhaps if there were guidelines that  
24 said, "Do these offerings meet these particular  
25 criteria," then, you know, you're safe in engaging with

1 those companies.

2 CO-CHAIR GRAHAM: So are you suggesting,  
3 then, that there is little precedent, there is little  
4 that has actually happened which should give rise to  
5 these concerns?

6 MR. MALIN: Well, there haven't been that many  
7 offerings that have succeeded, of course.

8 CO-CHAIR GRAHAM: Right.

9 MR. MALIN: But again, you know, in my view,  
10 there has been significant vetting of --

11 CO-CHAIR GRAHAM: Yes. I was just  
12 wondering to what extent is it an issue of education --

13 MR. MALIN: I think to a large --

14 CO-CHAIR GRAHAM: As opposed to providing  
15 additional clarity.

16 MR. MALIN: Yeah. I think, to a large extent,  
17 it is education.

18 Okay, so I'm winding down through these case  
19 studies. I hope they are helpful, because, you know, we  
20 did think a lot about which ones could be useful to share  
21 here.

22 So, again, you know, we continue to iterate  
23 here, in terms of what we think can drive a successful  
24 offering. NewsBeat Social came to market again. This  
25 was a company that sought to leverage a worldwide

1 community of readers of its news. So it produces  
2 one-minute videos to be displayed on Facebook. And they  
3 had worldwide -- you know, over four million -- viewers  
4 of their content. So again, the opportunity to engage a  
5 broad community of interested parties in this offering  
6 was appealing.

7 They established a minimum of only \$1 million.  
8 So they wanted to ensure success, they wanted to make  
9 that hurdle low enough that they could meet that minimum  
10 and raise capital beyond that, if it were to materialize  
11 from their community of fans. And they were targeting a  
12 NASDAQ listing for the securities, given that they would  
13 raise enough money to meet the minimum criteria there.

14 And so, what Hambrecht advised was a sequenced  
15 marketing effort, where the company itself, largely,  
16 would market to its community of readers, fans, until it  
17 raised enough money -- which was going to be about \$7  
18 million -- to meet NASDAQ listing criteria. Once we were  
19 confident that it was going to be a NASDAQ-listed  
20 security, we felt certain that we could then go to our  
21 institutional clients and our community of independent  
22 broker-dealers to sell it beyond that. So that NASDAQ  
23 seal of approval was an important component in this  
24 offering.

25 But again, what we found was the conversion

1 here was extremely unpredictable. And, in fact, they  
2 were never able to raise that minimum to meet the listing  
3 standard at NASDAQ, and which was -- this was interesting  
4 in that -- so, despite the fact that they had said a  
5 successful offering would be anything over a million  
6 shares, it truly wasn't, because the intention to list on  
7 NASDAQ imposed a floor that was much higher, quite  
8 frankly, than that one million.

9 So, again, you know, failed to meet that  
10 minimum required to list on the NASDAQ and to close on  
11 that initial amount of money, and we -- again, we never  
12 had the opportunity to pursue those additional channels.  
13 So it was purely a crowdfunding effort, the crowd proved  
14 unpredictable, and they were unsuccessful in completing  
15 that transaction.

16 MS. YAMANAKA: Did they never try it, or did  
17 they feel they would be not successful in pursuing the  
18 broker-dealer and institutional channels?

19 MR. MALIN: So when we advise this sequenced  
20 marketing effort, we warned that, without confidence,  
21 that -- the shares would be listed on NASDAQ, it would be  
22 very, very difficult to engage institutions and the  
23 broker-dealer network.

24 We did speak to some institutions, and really  
25 validated our position there, because most said, "Call me

1 them, in terms of making it feasible for them to use you,  
2 but, you know, stage, I assume, the cost also? Again, I  
3 know it's sort of a proprietary question, but --

4 MR. MALIN: Yeah. The large majority of our  
5 fees are earned as success fees. So again, we're  
6 interested in these companies succeeding. We bring  
7 companies to market that we believe have a strong chance  
8 of succeeding. All of these companies in our case  
9 studies we expected to end up with successful offerings.  
10 We were not looking to expend our energy on failed  
11 offerings, there is no question about that.

12 So, we did vet these carefully, and felt that  
13 each had a reasonable chance of success -- more than  
14 reasonable, quite frankly. But, you know, as I've said,  
15 we are learning along the way here those things that make  
16 it challenging to complete these offerings.

17 MS. MOTT: Rob, what was the average age and,  
18 you know, how much history did you have on each one of  
19 these companies? Can you give me that?

20 MR. MALIN: Yeah. So it varies, certainly.  
21 But I would absolutely characterize all of these  
22 companies as early stage. So, less --

23 MS. MOTT: Three years?

24 MR. MALIN: Less than four years.

25 MS. MOTT: Less than four years?

1 when you're meeting the NASDAQ standard. Interested in  
2 participating if it's going to be a NASDAQ-listed stock.  
3 If not, I'll pass." So --

4 CO-CHAIR GRAHAM: And that was a concern  
5 with respect to liquidity?

6 MR. MALIN: Yes, I think to some extent. But  
7 also, again, was perhaps just this knee-jerk reaction.  
8 "I will participate in listed underwritings, and I am not  
9 going to expend the time and energy to look at something  
10 that is not going to be a listed offering."

11 CO-CHAIR GRAHAM: So, concern, then, that  
12 disclosure or governance might be substandard?

13 MR. MALIN: That's exactly right.

14 MR. YADLEY: To the extent you're comfortable  
15 speaking about this, one of the things that members of  
16 this committee who are either attorney advisors or actual  
17 companies who have done public offerings have had to  
18 grapple with is the cost. So Hambrecht, even as my days  
19 as a staffer here, is to be commended for a willingness  
20 to work with smaller companies and sort of share in the  
21 pain. And you've been candid in saying it's not  
22 thrilling to not feel that you've earned your fee with  
23 these companies.

24 It sounds like the advice you gave NewsBeat  
25 Social was right on. How did you, in general, work with

1 MR. MALIN: Yeah. In some cases --

2 MS. MOTT: Okay, so did they --

3 MR. MALIN: -- less than two.

4 MS. MOTT: Okay. Did they have some -- were  
5 they capitalized prior to this with private investors?

6 MR. MALIN: Most were not. Most had had angel  
7 and friends and family-type investments. Some had more  
8 substantial private investment. But, for the large part,  
9 most of these are -- this is their first  
10 institutional-type capital.

11 MS. MOTT: So, my question is, I look at this  
12 and look at the three tiers you've identified as  
13 marketing -- you know, the institutional investors, the  
14 broker-dealers, particularly those two buckets. Were  
15 they trying to -- you know, I look at this as this is a  
16 typical private offering. You know? And -- because it  
17 doesn't have a history. You can't do a discounted cash  
18 flow, because it hasn't -- you know, and some of them,  
19 very minimal cashflow, right?

20 So, were they trying to fit a square box into a  
21 round hole? In other words, their criteria doesn't fit  
22 how they've always handled securities. So, therefore,  
23 they didn't feel comfortable. I mean there -- was there  
24 a road block there?

25 MR. MALIN: Yeah, absolutely. And, as a matter

1 of fact, it was something I was going to touch on, but  
2 I'm happy to do it now.

3 We view the Reg A+ market to include different  
4 types of companies, certainly. Those that we call sort  
5 of the mini-IPO candidates are more mature, and they  
6 would more typically fit a large institutional investor's  
7 criteria. So what is that? And I think we use shorthand  
8 that -- significant revenues, call it 25 to \$30 million  
9 or something per year, a path to EBITDA positive, if not  
10 currently EBITDA positive.

11 So, those are, you know, the types of companies  
12 that might pursue a Reg A because it has been great, in  
13 terms of reducing the time and the cost of doing an  
14 offering. But they really are positioned to attract  
15 large institutional investor attention. That said, some  
16 of those may only want a raise 10 or \$15 million. So  
17 then we're in a little bit of the same position, where  
18 institutional investors may say, "Boy, my bite size is  
19 much larger than a 10 or \$15 million offering can really  
20 afford. How can I participate?"

21 So, again, this is where, personally, I believe  
22 that this opportunity to bring companies that fit into  
23 that middle area where I want a raise 5 to 15 or 5 to \$20  
24 million -- it's still a small offering. That should be  
25 an area where perhaps some small institutions play, but

1 CO-CHAIR GRAHAM: But they -- you know, I  
2 think the other way to look at it might be -- is that,  
3 essentially, what you're talking about -- or at least in  
4 a number of instances -- are the equivalent of a series A  
5 or a series B. And that typically -- you don't need to  
6 explain that to these institutional investors, that this  
7 is a small private placement. And this is my  
8 understanding that these -- that traditionally, these  
9 institutions don't have an appetite for that. So what's  
10 the surprise?

11 MR. MALIN: Well, I think that's right. And  
12 again, I think perhaps my experience is limited. But  
13 there are other institutions out there that do actively  
14 participate in the private placement market. You know,  
15 there are other broker-dealers, competitors of ours, that  
16 have great success in bringing small private deals to  
17 market, and do that through, often times, a proprietary  
18 community of investors --

19 CO-CHAIR GRAHAM: But I would imagine that  
20 those entities are more receptive, as well.

21 MR. MALIN: I think that's right.

22 CO-CHAIR GRAHAM: Because they view it as  
23 what it is, essentially a small private offering.

24 MR. MALIN: Yeah --

25 CO-CHAIR GRAHAM: You know, I want to make

1 the bulk of those would likely be sold through that  
2 broker-dealer network, those self-directed investors who  
3 have brokerage accounts open, are seeking investment  
4 opportunities.

5 I mean the E\*Trade, Scottrade, TD Ameritrades  
6 of the world, Fidelity, Schwab have many, many of these  
7 investors that would love to invest in earlier-stage  
8 companies, and understand the risks of investing in  
9 earlier-stage companies. But again, the -- we're not  
10 seeing broad participation among --

11 MS. MOTT: So that goes back to, I think,  
12 someone else's question earlier. It begs the question of  
13 do we need current guidelines to help with this, so that,  
14 you know, the broker-dealers can understand that they  
15 would view this differently and -- you know what I mean?  
16 And not try to fit it into -- you know how you normally  
17 would treat --

18 MR. MALIN: Right.

19 MS. MOTT: You know?

20 MR. MALIN: Yeah, I think it's a double-edged  
21 sword, right? Because, again, you want these to look and  
22 feel as much like any other public offering because, in  
23 fact, you're producing securities that are freely  
24 tradeable and, in many respects, meet all those same  
25 criteria.

1 sure we get to Brad.

2 MR. MALIN: Yeah, yeah.

3 CO-CHAIR GRAHAM: And so --

4 MR. MALIN: So I'll finish up here. I realize  
5 that it's going on. I apologize, Brad.

6 MR. EICHLER: No, no, it's fine.

7 MR. MALIN: So I will just close with one final  
8 case study here. You know, ShiftPixy is an offering that  
9 we worked on at the end of last year and will bring it  
10 again in the coming months. But again, you know, we're  
11 tweaking our advice to these companies. We felt it was  
12 important. ShiftPixy was one of these later-stage  
13 companies, in terms of generation of revenues, but it was  
14 earlier-stage in terms of life. It's young, less than,  
15 really, 18 months old when we were on the road with it.  
16 But it was generating meaningful top-line revenue.

17 They pursued a min-max structure, 15 to 50  
18 million, and targeted a NASDAQ offering. That 15 million  
19 was set intentionally to ensure that a deal would not  
20 close unless it met the minimum to be listed on NASDAQ.  
21 And I -- this, I think, goes to your point. The deal did  
22 meet institutional investor standards. So we had road  
23 show meetings with over 50 institutional investors where  
24 I think we were surprised -- well, I should rewind a  
25 little bit.

1 Reg A+ at that point, the end of last year, was  
2 not an issue. The institutions now understood it was a  
3 regulatory framework. They were looking at a Form 1-A  
4 that looked very much like every S-1 that they have ever  
5 reviewed. They understood the disclosure, going forward  
6 as a NASDAQ-listed company, was going to be identical to  
7 all their other holdings. And so there is a high degree  
8 of comfort in reviewing a Reg A+ offering.

9 Where there was some hesitation was that, given  
10 that we were going to market this to all three  
11 channels -- so we saw it -- qualification, had a set  
12 price for this offering, so that the individual community  
13 could participate. The institutions balked a bit at  
14 that. They said, "What happened to our opportunity to  
15 voice an opinion on valuation?" So a fixed-price  
16 offering was a little bit unusual for the institutions to  
17 digest.

18 So, you know, I think there were other issues.  
19 Quite frankly, the -- you know, it was a very early-stage  
20 company. We probably could have done more to bolster  
21 their institutional appeal, in terms of placing, you  
22 know, a CFO earlier, building out the board, et cetera,  
23 all those types of things, which, you know, we've learned  
24 and when we come back to market we'll address some of  
25 those shortcomings.

1 But again, this speaks a little bit to the  
2 institutional investors. While they now understood that  
3 Reg A was -- made perfect sense, they're still a little  
4 hesitant to embrace those very, very early-stage -- and  
5 so young companies.

6 So, I'll close with just a recap. And I think  
7 I've touched on a lot of these things that -- again,  
8 Hambrecht can account for 200, 250 companies that have  
9 expressed interest in pursuing a Reg A offering. It  
10 makes sense for them in a variety of ways. The promise  
11 of a less expensive and more efficient pathway to a  
12 public offering has largely been realized. So commend  
13 the Commission on creating the rules that have made it  
14 more efficient for companies to get to the starting gate  
15 of an offering there, and the cooperation, because the  
16 review periods have been, you know, very reasonable.

17 Again, and as you've heard me say, the  
18 distribution of these offerings has really been the  
19 challenge. The institutions may or may not be relevant  
20 for many of these offerings. The broker-dealers have not  
21 generally participated in deals that are not going to be  
22 NASDAQ-listed. So, for all those deals, for all those  
23 many companies that see Reg A+ as appropriate for them,  
24 but don't yet see a public listing as appropriate, they  
25 haven't really found a home here yet.

1 And again, I've said it way too many times, but  
2 the crowd is highly unpredictable.

3 And my last couple of points, this disconnect  
4 does remain here, where issuers see the value, they  
5 understand that they're doing a lot to make their  
6 offering appealing to a broad community of investors, so  
7 they're willing to endure a review by the SEC, they're  
8 willing to endure, you know, a deep due diligence effort  
9 by an underwriter. But they're not being adequately  
10 rewarded, in their view, by investors for willing to  
11 subject themselves to that level of scrutiny.

12 And some underwriters, I would say also, don't  
13 see the point of a Reg A, either. Many say, "Well, if  
14 it's a company that is destined for NASDAQ or NYSE, why  
15 don't they just do an S-1?" And I think, in many of  
16 those cases, they are missing the point that, for these  
17 smaller companies, cheaper/faster makes a big difference.

18 And then the last being that, you know,  
19 marketing, while a critical component for success in  
20 generating crowd interest, is not a panacea. Doesn't --  
21 can't always get you to the finish line.

22 And then finally, thoughts around  
23 recommendations because, again, I don't think I have any  
24 real concrete recommendations, and some we've already  
25 touched on here a little bit. But are there ways to

1 provide greater clarity, greater guidance for,  
2 particularly, broker-dealer participants in these  
3 offerings? To engage them in a manner that we can get  
4 that community of retail participants involved with a  
5 high level of confidence that they're not going to endure  
6 tremendous scrutiny from FINRA by participating in these  
7 deals.

8 So, again, I think it is an educational effort.  
9 But -- and my first recommendation is, you know, just  
10 continued support of this Reg A+ effort by the Commission  
11 is greatly appreciated. The data dissemination, like  
12 that report of earlier this year, and education, and  
13 certainly cooperation in getting these deals through the  
14 pipeline is -- has been great. So, again, commend the  
15 SEC on that effort, and I think that is working. That  
16 part of this is working. And it's just the -- where the  
17 rubber meets the road a little bit on the sales.

18 CO-CHAIR HANKS: Thanks, Rob, and we'll go  
19 straight to Brad. And I know we'll have some chance to  
20 ask further questions, which I think -- there are still a  
21 few -- after we get through and hear what Brad has to  
22 say. Thank you.

23 MR. EICHLER: Thank you very much, Chair, and  
24 thank you to the whole committee and Commissioner Stein,  
25 as well. My comments will be relatively brief. I've got

1 a few slides put together, and it will be a little bit  
 2 different perspective than what Rob laid out, maybe from  
 3 a little bit higher level.  
 4 I want to go back to two comments that Chair  
 5 Hanks made and Commissioner Stein made at the beginning.  
 6 One was you got to have the right ecosystem in place.  
 7 And the ecosystem that focuses on small cap stocks is  
 8 under attack. And that's one of the things that I'll  
 9 talk about in here today. And I think it's imperative,  
 10 if we want to have an active market for small-cap stocks  
 11 and small-cap IPOs, that you got to have people that are  
 12 interested in those deals. That's point number one.  
 13 Point number two is a comment that Commissioner  
 14 Stein made. Investment follows trust. We look at it as  
 15 the IPO is just the first step in a life span with the  
 16 company. It's getting them public, but then all the  
 17 investors -- I mean the IPO, for us, is a time to bring  
 18 together an issuer, which is a client of ours, and our  
 19 institutional and retail clients of ours, and put those  
 20 together in a transaction where everybody walks away and  
 21 they feel like they got a good deal on the transaction.  
 22 And as we're often fond of saying, you know,  
 23 the demand for stocks that go down is zero. And so we're  
 24 highly incentivized to make sure we price a transaction  
 25 correctly, make sure we trade the transaction post-deal,

1 and support that company so that the company is in a  
 2 better spot one year, three years, five years down the  
 3 road, and the investors that own that are in a better  
 4 spot one year, three years, five years down the road. And  
 5 so, that's kind of our high-level perspective. But I  
 6 thought both those comments were very insightful, and  
 7 directly relate to what I was going to say.  
 8 I've got no slides on Stephens. Just quickly,  
 9 Stephens was founded in 1933 by the Stephens family.  
 10 It's been owned by the Stephens family, continuously. We  
 11 have one shareholder today, that's Warren Stephens. It's  
 12 a very unique ownership model. We don't like and don't  
 13 see how you could be a publicly-traded firm that's  
 14 offering advice to people that doesn't correspond with  
 15 quarterly results, and so we like the fact that we're  
 16 private.  
 17 Our equity business began in 1970. Our second  
 18 deal, we were fortunate enough to do a little retailer in  
 19 Northwest Arkansas called WalMart. It was interesting,  
 20 \$4.95 million offering. At the time they had 30 stores,  
 21 30 million in sales, roughly. Of the 4.95 million, 1.5  
 22 million of it was selling shareholders. And it was a  
 23 prospectus that was printed on small paper, and I think  
 24 it was 24 pages long. So it was an interesting deal.  
 25 (Laughter.)

1 MR. EICHLER: And then, as Chair Hanks  
 2 mentioned, I started off on the research side of the  
 3 firm. I've been at Stephens for 26 years this July.  
 4 Started off as a junior research analyst, research  
 5 analyst, ran research, and have run banking for the last  
 6 decade.  
 7 So, just to set the stage, you know, the number  
 8 of public companies has declined by 50 percent when you  
 9 go back over the last 20 years. Yeah, obviously, M&A  
 10 plays a role in that, private transactions play a role in  
 11 it, and company failures. But it's dramatic, when you  
 12 look at what's happened over that time period.  
 13 When you look at IPO trends, the top chart  
 14 here -- and, I'm sorry, it's a little bit hard to read  
 15 from the back of the room, but the top chart shows the  
 16 number of IPOs by year, going back to 1995 on the  
 17 left-hand side to 2017 on the right.  
 18 One of the things I would point out is, you  
 19 know, in that pre-2000 period we were averaging 400 deals  
 20 a year, 400 IPOs a year. The average IPO size -- median  
 21 IPO size -- was about \$30 million. And now we're  
 22 averaging, over the last -- since 2008, 130 deals a year,  
 23 and the median deal size is \$100 million, or slightly  
 24 north of \$100 million. And so, obviously, there is  
 25 something that is not working right, and I will get into

1 some thoughts on that in just a second.  
 2 The bottom chart looks at IPOs for companies  
 3 that have a \$100 million or less market cap at time of  
 4 deal. And, as you can see over -- since 2008 we've  
 5 averaged 8.5 percent of deals are for, you know, true  
 6 small-cap companies, whereas, you know, if you go back  
 7 pre-2000, 30 to 50 percent of the deals were for that  
 8 same size company.  
 9 You know, one of the factors to consider, you  
 10 know, probably the biggest is the rise of private equity.  
 11 Our business is diversified private -- M&A is a big  
 12 portion of our corporate finance business. And, you  
 13 know, private equity is a -- between private equity,  
 14 venture cap firms, and family offices now, you're talking  
 15 about trillions of dollars of spending power that are out  
 16 just pursuing market -- pursuing companies aggressively,  
 17 particularly companies that are highly attractive to go  
 18 public. And with the amount of leverage that's available  
 19 today, the -- these firms can go out and earn a very  
 20 substantial rate of return by taking the company,  
 21 levering it, and putting it in their portfolio, growing  
 22 it, and then most of these firms prefer a clean exit on  
 23 the back end, where they sell the company, as opposed to  
 24 taking the company public. And so, that's one of the big  
 25 drivers.



1 Second, regulatory environment. From our  
 2 perspective, the JOBS Act has been a complete home run.  
 3 There are some fantastic features of it: test the waters  
 4 meetings, confidential filing, you know, reduced  
 5 financial disclosure, and what have you on the front end.  
 6 But what we continue to hear from clients is it's a  
 7 stifling regulatory environment, you know. And the  
 8 thought of going public, the costs associated with going  
 9 public are onerous. You know, companies are saying \$2  
 10 million a year, \$2.5 million a year. And as a small-cap  
 11 company, that's a meaningful -- going back to your  
 12 comment about, you know, D.F. analysis, that's a  
 13 meaningful impact to your cash flow and value of the  
 14 business.

15 And then, from the private equity -- the third  
 16 point, from a private equity or from a seller's  
 17 perspective, time to ultimate liquidity is a question.  
 18 You know, the IPO is just the first step. The market, as  
 19 everyone in here is probably aware, has become much more  
 20 accepting of selling shareholders on the front end,  
 21 particularly private equity-type investors. Not so  
 22 much -- management is not something that we would be  
 23 comfortable with, as a firm. But when you combine  
 24 partial liquidity on the front end with the risk of the  
 25 market and selling additional stock in the future,

1 sometimes an M&A transaction is just a much more  
 2 appealing exit for a small cap business.

3 Next we looked at what we think is needed for a  
 4 favorable IPO market. And really, it's a confluence of  
 5 three items. One, we're seeing today, which is, you  
 6 know, attractive valuations in the market and low levels  
 7 of volatility. And, you know, there is a front-page  
 8 article in the Wall Street Journal yesterday saying how  
 9 the VIX is -- the volatility index is at its lowest level  
 10 in 30 years, which, personally, scares me, as somewhat of  
 11 a contrarian, because there is only one way it goes from  
 12 its lowest level. But you need that.

13 And so, when you look at the year to date,  
 14 we're on pace -- basically, paced to equal last year,  
 15 about 100 IPOs. But I will tell you, just looking at our  
 16 firm and other firms out there, there is a tremendous  
 17 backlog that's building now. And I think if the markets  
 18 stay where they are, we will have a very strong second  
 19 half of the year. So that's number one.

20 Number two is a favorable regulatory  
 21 environment. Obviously, I mentioned the JOBS Act, which  
 22 has been very positive. But you know, just as a  
 23 general -- a lot of our business, for example, is with  
 24 community banks. The regulations there are very onerous.  
 25 And, you know, it's something that shapes the decision of

1 a company to pursue an IPO versus an all-out sale of the  
 2 business.

3 And then, number three is a comment that I  
 4 started with, which is post-deal sponsorship. You know,  
 5 for us, getting public is really half the battle. The  
 6 biggest part is what happens from that point forward.  
 7 Because as -- everybody that's an investor is concerned  
 8 with, you know, a return on the stock. So, from our  
 9 perspective, research support is essential to that  
 10 communication, and providing information flow to  
 11 institutional and individual investors. Trading support,  
 12 particularly for small-cap stocks, is extremely  
 13 important. Providing liquidity in issues that don't have  
 14 a lot of liquidity, and being able to locate stock for  
 15 people, because it's more challenging than trading shares  
 16 of Apple, for example.

17 And when you look at it, there is a general  
 18 movement away from small-cap companies. You know,  
 19 Commissioner Stein made a comment about economics in her  
 20 opening remarks. And, at the end of the day, that's  
 21 really what it comes down to. And if you look at all of  
 22 the middle-market firms that we kind of think of as our  
 23 peers -- Piper, William Blair, R.W. Baird, and if you  
 24 looked at a time series of their research coverage  
 25 average market cap, it's gone up, and it's gone up, and

1 it's gone up. And the reason that it has is not because  
 2 they don't want to follow these small companies. The  
 3 reason it has is because it's hard to generate an  
 4 economic return trading small companies with -- and I'm  
 5 going to get into some of the things that have impacted  
 6 that -- but it's hard to do that.

7 And so, that's been the biggest challenge.  
 8 And, you know, the overall thesis of what I -- my  
 9 comments are today is you got to preserve that ecosystem  
 10 if you want to have a healthy, small-cap IPO environment.

11 As far as issues to consider to make the public  
 12 markets more attractive, as I mentioned, the JOBS Act has  
 13 been a big positive. I think everybody in our industry  
 14 would agree with that. And we're starting to see some of  
 15 those regulations permeate, even into some larger-type  
 16 offerings with proposed confidential filings for larger  
 17 companies. We have not done a Reg A offering. And so,  
 18 Rob, listening to everything that you went through is  
 19 very interesting for me. You know, at the end of the day  
 20 there is not a demand from our client base for that  
 21 product.

22 And so, Chair Graham, you were asking a  
 23 question about demand. You know, there is not a demand  
 24 for that product from our clients today. And when we  
 25 look at the data on it, when you think about post-deal

1 liquidity, when you think about research coverage  
2 post-deal, sponsorship, all those things, you know, where  
3 you've got somebody that's constantly trying to get the  
4 company out in front of new potential investors, the data  
5 is very limited. But what the data -- the limited data  
6 tells you is that that's been relatively unsuccessful.

7 Sponsorship post-deal, the role of the  
8 sell-side analyst continues to be diminished and eroded.  
9 It's caused a lot of talent to leave the industry to go  
10 to that other side, the buy-side of the industry. It's  
11 created much more of a short-term focus in the way that  
12 people think about things. And what I would say is that  
13 their reduced role on an underwriting, from an issuer's  
14 perspective, is just a continued question mark.

15 You know, today a research analyst has a very  
16 limited amount that it can share with a management  
17 company as they're contemplating an IPO. And so, imagine  
18 if you're the company, you're the CEO, you're doing  
19 something you've never done before, going public, and you  
20 want to talk to the -- you don't want to talk to an  
21 investment banker about it; you want to talk to the  
22 person that's closest to the investors, and find out what  
23 are investors thinking, what are the metrics that they're  
24 looking at. And the restrictions are you can't do that.

25 And so, it's kind of like, you know, I want to

1 We put an -- just one case study in here. I  
2 did not put the company's name. I'm sure people could  
3 figure that out. But it is comparing a Reg A deal to S-1  
4 registered deals. And what we tried to do was look at,  
5 you know, market cap. Market cap for the Reg A business  
6 was about 270 million. And what we did is we picked 35  
7 deals from 2015 that were S-1 deals that were all in the  
8 same size range, and looked at those versus the Reg A  
9 deal. And forget the performance of the stock. The Reg  
10 A deal traded down. The comp group traded up. But  
11 you're talking about 1 company versus the aggregate of  
12 35. So I don't think that's as meaningful.

13 But what is meaningful is when you look at  
14 research coverage, 0 for the Reg A company, 5 for the S-1  
15 registered companies, on average. And then, when you  
16 look at trading volume, which -- you know, several  
17 questions have been asked -- 106,000 versus 7,000 average  
18 daily trading volume. And, you know, I mean, I just  
19 think of all of us as potential investors, which one of  
20 those companies is going to be more attractive to us?  
21 And it's the one that's got more research sponsorship and  
22 trades more. Forget what the performance of the company  
23 has done.

24 So, just in conclusion, we started the  
25 presentation thinking about, okay, what would be a good

1 sell my house, but I can't talk to a Realtor about what  
2 the house is worth. I mean it just doesn't make sense.  
3 And a lot of that goes back to the investment bankers to  
4 provide a lot of that data, and it's just -- from a  
5 filter perspective, it would be a lot better coming from  
6 somebody that's actually right there, talking to clients  
7 every day.

8 And then, on regulations, you know, again, what  
9 I would just say from a high level is there are a lot of  
10 firms that care about this part of the market. There has  
11 been a lot of regulations that have continued to make it  
12 less and less economically viable for them to pursue this  
13 part of the market. And so, you know, just as we think  
14 through it, Glass-Steagall, decimalization, the global  
15 settlement, tying of investment banking and lending  
16 activities, and then some pending stuff with desk  
17 commentary, MiFID -- which is something that everyone in  
18 the industry is taking extremely seriously, at a time  
19 when Commission dollars are already down. This is the  
20 bifurcation of Commission and trading, and, you know,  
21 consensus thinking is it's going to have a -- wreak havoc  
22 on Commission dollars going to firms to pay for research,  
23 essentially.

24 The bottom line of all that is it's impeding  
25 the information flow from analysts to investors.

1 conclusion, and we started with the mission statement of  
2 the SEC. And the mission statement is to protect  
3 investors, maintain a fair, orderly, and efficient  
4 markets, and facilitate capital formation. So three  
5 things that we would suggest, with all respect to the  
6 committee.

7 Number one is -- the protect investors  
8 category -- is let analysts try to help clients make  
9 money. And if clients are making money, that is going to  
10 drive demand for more product that they can make money  
11 on. And that's a positive for all of the small-cap IPOs  
12 that we're talking about, number one.

13 Number two is tying is rampant. It's something  
14 that we face every single day in our business. It's  
15 something that no issuer is going to come here and  
16 complain about, because all of the issuers are highly  
17 dependent upon leverage in their model. And if somebody  
18 is loaning them money and demanding investment banking  
19 work as part of that, they are not going to -- they are  
20 going to go along with it. But we see it day and day and  
21 day again. And again, these aren't the middle-market  
22 firms that are tying. These are the big banks that are  
23 tying. And what it's doing is taking economics out of  
24 the model, and it's taking economics out of the model to  
25 groups that don't care about small-cap stocks.

1 And so, in the interest of time I didn't put  
 2 slides in here, but if you look at the market share for  
 3 the middle-market firms over the last decade, it's gone  
 4 down materially every -- over that time period. And the  
 5 reason why is because more of these underwritings are  
 6 going to -- a disproportionate share are going to the  
 7 larger firms that are lending money to these issuers.  
 8 And then, number three, under capital  
 9 formation, JOBS Act has been great. I'm personally  
 10 unsure of Reg A, and a lot of that is out of ignorance.  
 11 But I think the continued efficiency and cost  
 12 improvements are needed, anything that makes it cheaper  
 13 to go to market and remain a public company.  
 14 That concludes my remarks, and I'm happy to  
 15 answer any questions.  
 16 CO-CHAIR HANKS: Thanks, Brad. Actually,  
 17 one of the things I'd like to talk about more -- because  
 18 this has not been raised in this context -- is the tying  
 19 issue, the idea that, you know, large institutions are  
 20 sucking up business that the smaller broker-dealers might  
 21 have been able to handle, and might have been able to use  
 22 to foster capital formation by small companies. Can you  
 23 talk a little bit more about that and how it affects you?  
 24 MR. EICHLER: Yes. You know, I'm going to give  
 25 you two examples that just -- that I think will be

1 relevant. On an IPO for a sponsor-backed company,  
 2 financial sponsors, the oxygen in their model is  
 3 leverage. They have to have it on the front end to do a  
 4 transaction. You know, all the deals they do are  
 5 levered.  
 6 And so, when you look at the sponsor-backed  
 7 deals, typically those are going to lenders that are  
 8 providing -- you know, book-runner roles on those deals  
 9 are going to lenders that are providing financing to  
 10 those firms. Maybe not on that specific transaction, but  
 11 transactions in general. And what's interesting about it  
 12 is, you know, while the spreads on IPOs have -- they've  
 13 come down a little bit, but they've remained relatively  
 14 constant. What's changed dramatically is 10 years ago  
 15 book runners, in aggregate, got about 45 percent of the  
 16 economics on a deal, meaning 55 percent of it were going  
 17 to the co-managers. Today, when you look at it, 85  
 18 percent of the economics are going to the book runners,  
 19 and 85 percent of the -- and that's predominantly lenders  
 20 on the business. So that's the IPO example.  
 21 The follow-on example that I would give you is  
 22 we're increasingly seeing situations -- and again,  
 23 without mentioning any companies' names, but increasingly  
 24 seeing situations where we'll go to underwriting  
 25 committee, and you'll have a whole list of people that

1 are providing research coverage to the company, and the  
 2 underwriters that show up on the deal, a high percentage  
 3 of them provide no ongoing sponsorship to the company.  
 4 And it's hard to see where that is creating an  
 5 environment or ecosystem that is helping promote coverage  
 6 of and ongoing sponsorship of these small and mid-cap  
 7 companies.  
 8 And, you know, we've looked at it, Chair, as  
 9 well, where we've gone back and said, okay, what's the  
 10 research follow-through? You know, on an IPO, if you  
 11 look at middle-market firms, irrespective of where they  
 12 are on the cover, just if they're on the cover three  
 13 years later, how many of them still follow the name? And  
 14 then we looked at bulge bracket and said, okay, for bulge  
 15 bracket, if they're just the lead left, you know, how  
 16 many of them follow the name three years later? And the  
 17 difference is amazing. I mean, it's -- you know, you're  
 18 talking 90 percentage point kind of plus follow-through  
 19 versus 60 percent follow-through. And that's if you're  
 20 the book runner on the deal.  
 21 And so, it's just one of those that, again, to  
 22 have a successful small-cap ecosystem, you got to have  
 23 people that care about it. And the big guys, I mean,  
 24 that's just not -- that's not their business, just like  
 25 our business isn't raising funding for Apple or Google or

1 anybody like that today. It's just a different strata of  
 2 the market.  
 3 CO-CHAIR GRAHAM: Well, the ecosystem is  
 4 something that we have focused on for some time, off and  
 5 on. Just trying to understand what is real and what  
 6 isn't. Certainly a post-deal sponsorship is important,  
 7 and support from the standpoint of research, support from  
 8 the standpoint of trading, that's all well and good. But  
 9 how do you get there?  
 10 Is -- what do you see as some of the drivers?  
 11 I mean you mentioned some of the regulations. I think  
 12 we're all kind of -- we all kind of feel that a lot of  
 13 the regulations that have been placed -- put in place  
 14 over the last, you know, 10 years have contributed to the  
 15 decline, recognizing there is some -- there might be some  
 16 debate. But what about things like tick size, which we  
 17 will turn to later on this morning? The fragmentation of  
 18 the market? You know, coming up with an entirely new  
 19 exchange? What do you see as some of the things that  
 20 might be useful, in terms of driving additional support  
 21 on the research side and the trading side?  
 22 MR. EICHLER: Chair, I think all the things you  
 23 mentioned would all be helpful. I do think you have to  
 24 unshackle the research analysts a little bit, and let  
 25 them -- put them in a position where they can at least

1 have a conversation with management about being a public  
2 company, what to expect, what investors are looking at,  
3 and what have you. I think that will make a big  
4 difference.

5 But I really think it's kind of a collection of  
6 all these things. And, you know, all of the  
7 middle-market firms are -- and, you know, it's an  
8 ecosystem where we're all friendly with each other, but  
9 they're all working very hard to try to make sales  
10 trading and research a viable business. And, you know,  
11 spreads continue to get cut and cut and cut. And it's  
12 just one of those that, at some point -- and we've  
13 already seen some of our competitors do it, but at some  
14 point they're just going to say, okay, this part of our  
15 business doesn't make sense any more.

16 And I think, to this broader discussion about  
17 growth in IPOs, that's going to be a really tough day for  
18 how to grow more small-cap IPOs, because that group  
19 that's historically done it just continues to be under  
20 pressure.

21 So I think it's a combination of all the things  
22 you mentioned that bring a little more economics back  
23 into that model.

24 CO-CHAIR GRAHAM: What do you think might  
25 be most important? You know, like, from my point of

1 is a feeling among people who know anything about it, oh,  
2 that's -- you're like, that's a Morgan Stanley thing, it  
3 doesn't affect the smaller issuers and the smaller banks.

4 MR. EICHLER: So, first of all, I'm an  
5 investment banker, not a sales trading and research  
6 person. So I'll give it my best shot, but I think I've  
7 got it -- the high level.

8 So, by having to separate execution with what  
9 you're paying for research, the way that my understanding  
10 is, if the fund has got any money from European  
11 investors, it basically is going to have to adopt MiFID.  
12 So we look at it -- one of the things that's a little bit  
13 unique about Stephens and probably the other  
14 middle-market firms is, you know, it's kind of the old  
15 80/20 rule. The big guys tend to call on the top 100  
16 accounts. Those are the top commission payers in the  
17 U.S. It's your Fidelitys, Wellingtons, Putnams of the  
18 world.

19 We call on 1,000 accounts, and a lot of those  
20 are in what we call kind of fly-over states. We're on a  
21 road show, you'd typically be on a plane flying over  
22 them, not down there having a meeting with them. Some of  
23 those smaller accounts are probably not going to get  
24 wrapped up in that as much. But all of our larger  
25 accounts are going to be part of that.

1 view, it seems to me, like, if you have consolidated  
2 liquidity, eliminated a lot of the fragmentation, and  
3 increased tick size, that that would go a long way toward  
4 generating the support that we're looking for.

5 MR. EICHLER: Yes, sir. I would agree with  
6 you. You know, because, when you think about it, what  
7 most investors are concerned about is, you know, if I --  
8 can I make a return on this investment? And, you know,  
9 whether an institution's paying you two-and-a-half cents  
10 a share or three cents a share or five cents a share, at  
11 the end of the day, if you've done your work right,  
12 that's, hopefully, an immaterial amount relative to how  
13 much money you've made owning the security.

14 And so, you know, I think institutions, you  
15 know, when we went to best execution there, that was  
16 something that really put a lot of pressure on them. And  
17 then MiFID, on top of that, is going to put more  
18 pressure. And so it's just one of those that -- I think  
19 that there is a desire to pay, it's just a very difficult  
20 model to pay in these days.

21 CO-CHAIR HANKS: Actually, it would be  
22 really helpful to, I think, a lot of the people at this  
23 table and our audience if you could explain a little bit  
24 more about MiFID and the impact on research and the  
25 impact on institutions like yours. Because I think there

1 The fear for a firm like ours is, A, what does  
2 that do to the payments for research? But, more  
3 importantly, we've got a developed trading system --  
4 traders, position traders, sales traders, and it really  
5 generates a question as to what is the future of trading  
6 for small-cap stocks if that goes to a -- an environment  
7 where more and more of that high volume is going to be  
8 routed to huge marketplaces and not go through firms like  
9 ours.

10 And so, obviously, it's early on. But that's a  
11 concern, from our perspective, Chair.

12 CO-CHAIR GRAHAM: Other questions for Brad  
13 or Rob? Yes, sir?

14 MR. REARDON: I assume you know William Butler.

15 MR. EICHLER: Yes.

16 MR. REARDON: Tell you how old I am, my  
17 daughter and William were in high school together.

18 MR. EICHLER: He worked for us, and he was a  
19 good client of ours, so both.

20 MR. REARDON: Yeah, he got you to open a Fort  
21 Worth office, I understand.

22 MR. EICHLER: That's correct.

23 MR. REARDON: So -- and what energy company is  
24 he with now?

25 MR. EICHLER: Well, he has been with two that

1 have both gotten purchased. So I can't tell you the  
2 current one he's with, but --

3 MR. REARDON: He's done well.

4 MR. EICHLER: Yeah.

5 MR. REARDON: Is your customer base primarily  
6 retail, or is it institutional in your firm?

7 MR. EICHLER: It's both. But it would be -- on  
8 any of our underwritings, it's predominantly  
9 institutional.

10 MR. REARDON: Institutional?

11 MR. EICHLER: Yes.

12 MR. REARDON: Well, if you were, say, like a  
13 Raymond James, which is in -- is based in Florida and has  
14 a lot of retirees who are their customers, and so more of  
15 a retail base, would that affect your ability to do these  
16 deals, or -- in other words, is -- are you swimming  
17 upstream by focusing on the institutions?

18 MR. EICHLER: In the deals being more small cap  
19 or more Reg A, or what --

20 MR. REARDON: Well, either one.

21 MR. EICHLER: We've always -- you know, we've  
22 got 130-ish private-client brokers that focus on  
23 larger-than-normal-type accounts. And we've always  
24 viewed the relationship we have with those accounts as,  
25 you know, a very significant asset. And so, when we look

1 you mentioned a lot of Reg A deals that have been  
2 started, maybe not so many have been completed. What do  
3 you see as the primary issue with failure to complete?

4 MR. MALIN: Yeah, I think I did mention that,  
5 and I think it is this -- where the rubber meets the  
6 road. These deals need to be sold. And finding adequate  
7 demand for these deals is a different exercise for each  
8 deal, because I agree with Brad: certain investments  
9 are appropriate for certain investments. So I think it's  
10 important that, for each deal, we are pursuing the  
11 appropriate investment community.

12 And, as you could gather from my comments, I  
13 think where the current market stands is that perhaps the  
14 appropriate community isn't being engaged in some of  
15 these transactions. So, for a transaction that is less  
16 than something that would be listed on a national  
17 exchange, but a strong company, and may be appropriate  
18 for a broad community of retail investors, they're really  
19 not getting that access, because it's not being supported  
20 by their brokerage firms.

21 CO-CHAIR GRAHAM: Okay. So it sounds like  
22 it's an investor community issue more so than a  
23 regulatory issue, and -- except that you feel that  
24 perhaps the issues relating to -- or perceived issues  
25 related to broker-dealers might be driving the inability

1 at those accounts, we tend to provide a finer screen, if  
2 you will, on stuff that we would show to our private  
3 clients.

4 And, as a result of that, a lot of these  
5 earlier-stage companies we would just deem as too risk to  
6 show to that group. You know, the old adage at  
7 Stephens -- and, you know, Warren Stephens comes to every  
8 single underwriting committee meeting, he sits in every  
9 one of them. And the way that we've always looked at  
10 things is would we invest in this business at this  
11 valuation with this management team? And, you know, if  
12 the answer to that is no, we have a really hard time  
13 doing the deal. And if the answer is -- got any -- if  
14 there is any questions in terms of size, profitability,  
15 anything, we will limit it to what accounts, what type of  
16 speculative accounts could pursue that. But we tend to  
17 really protect that relationship.

18 And so, when it comes to earlier illiquid,  
19 smaller investments, those aren't typically things we  
20 would sell through our retail group.

21 MR. REARDON: Thank you.

22 MR. EICHLER: Yes, sir.

23 CO-CHAIR GRAHAM: I have one last  
24 question -- and, Rob, you probably already answered this.  
25 But just for -- just to make sure that I'm clear on it,

1 to perhaps identify and reach the community of investors  
2 that might be interested in that particular investment.

3 MR. MALIN: I think that's right. I think --  
4 yeah. And maybe if I were to restate that -- I think I'm  
5 saying the same thing, but the hesitancy on the part of  
6 those broker-dealers to recommend or advertise these  
7 securities to their community of investors, whatever they  
8 deem is appropriate, again, within their community, is  
9 just -- it's not there due to the concerns around perhaps  
10 undue scrutiny on the part of FINRA.

11 CO-CHAIR HANKS: I want to get down into  
12 the regulatory weeds for a second. And one of the things  
13 that you mentioned, Rob, was the difficulty in getting  
14 Elio, I think, through the trading process. I feel your  
15 pain, since we're doing that with one of my clients at  
16 the moment.

17 And in the big, grown-up world of large IPOs,  
18 it's super-easy to get through DTC and 211s, and -- why  
19 is it so difficult, and what could we suggest to either  
20 FINRA or the SEC to make that process easier? Because it  
21 should be super-simple, right? They're filing Reg As, so  
22 boom, they should --

23 MR. MALIN: Agreed. Fortunately, I was not  
24 there at the time, so I didn't endure that pain that  
25 you're currently experiencing, but I understand that it

1 was substantial. I'm clearly not, probably, the right  
2 person to answer that question.

3 I know that you know Cromwell well, and I think  
4 he's viewed that process a number of times. And he's  
5 probably somebody that would have greater insight on  
6 exactly where the gears got gummed up in that process. I  
7 know my former colleague expressed exactly the same  
8 frustration that you did going through that process, and  
9 part of that he attributed to the fact that it was the  
10 first. But I --

11 CO-CHAIR HANKS: The second is equally  
12 painful.

13 (Laughter.)

14 CO-CHAIR HANKS: We'll follow up on that  
15 one, thanks.

16 PARTICIPANT: I just wanted to go back to a  
17 question that Patrick had asked. I just emailed some  
18 people from our IPO team, and we absolutely in NASDAQ  
19 will qualify best efforts offerings in the Reg A+ space.  
20 We have, and we will continue to do so.

21 MS. YAMANAKA: So I think this question might  
22 be to Rob. So do you feel that it's just we're early on  
23 in this stage? I kind of look at this as a new  
24 disruptive kind of product, right, and that we're very  
25 early on in getting a handle on who is going to buy, how

1 that they're not giving up anything when they choose a  
2 Reg A+ regulatory framework versus a fully registered  
3 offering. They still have all the optionality on the  
4 back end to be a listed company if they so choose.

5 MS. YAMANAKA: So they feel, over time, that's  
6 just a maturity of market, education, broker-dealers will  
7 wise up?

8 MR. MALIN: I think it is, yeah.

9 MS. YAMANAKA: Institutionals will still be  
10 dropping down to try to cherry-pick, right? I mean it's  
11 the nature of business.

12 MR. MALIN: Yeah, and I think, unfortunately,  
13 if W.R. Hambrecht has some successes, there will be many  
14 imitators right away. And so we'll have lots more  
15 competition in the Reg A space, as soon as we can prove  
16 that this is a legitimate way to enter the market.

17 MS. MOTT: So I'm going to follow up with that,  
18 because I'm thinking again back to -- my original  
19 question with you, Rob, was that, you know, what was the,  
20 you know, historical age of the company.

21 So, last year in the United States, \$27 billion  
22 went into angel capital, you know, funding -- 27 billion.  
23 And I think about that and think that, to me, this is --  
24 these are private offerings, you know, they match very  
25 closely to what this asset class is investing in. If

1 we sell, making the mistakes. So do you perceive that,  
2 over time, we'll get better, the market gets better, and  
3 it evens out?

4 Or is this one of the things that -- we had a  
5 speaker last time who said burn once, we're not going to  
6 touch it again, right? So is -- I know this is crystal  
7 ball time, but --

8 MR. MALIN: I absolutely think it's going to  
9 get better, and we've seen it improve. I continue to  
10 believe that Reg A+ is an excellent alternative for any  
11 company that's raising less than \$50 million. So, while  
12 Brad says, "Oh, I'm not sure if it works for everybody,  
13 but when you think about the idea that you can more  
14 officially navigate the SEC process, have lawyers that  
15 are potentially less expensive for a completion of a 1A  
16 versus an S-1, and you know, all those things, even if,  
17 in every other respect you're going to be exactly like  
18 every other listed company, you're going to pursue a  
19 NASDAQ or New York Stock Exchange listing, it certainly  
20 would make sense.

21 And so, perhaps evidence of that is that, of  
22 those 200, 250 companies that we've engaged, I think  
23 nearly 100 have been health care or life sciences  
24 companies, which typically are those companies that raise  
25 less than \$50 million in an offering. So they understand

1 you're finding that market, and -- I would think it would  
2 be pretty attractive to that market, because it's well  
3 vetted by institutional professionals, things like this.  
4 It makes a lot of sense. And you're looking to build 5  
5 to 10 percent of your portfolio, you're spreading it out  
6 in this, you know, private -- you know, in this  
7 early-stage asset class. Could it be just about finding  
8 the right investors, finding the right match? I don't  
9 know. It just --

10 MR. MALIN: I think it largely can be. And  
11 your point is well taken. So I posed almost the  
12 identical question to a partner broker-dealer of ours who  
13 services a community of investors that typically invests  
14 in private offerings. And I said, "It seems to me that  
15 anybody who considers a private offering should consider  
16 these offerings, whether they're listed or not. Because,  
17 regardless, they're getting a freely tradeable security,  
18 and a company that will have ongoing reporting  
19 requirements. That, to me, sounds better -- even if  
20 liquidity is extremely limited, it's still probably  
21 better than a private.

22 And his response was, "I couldn't agree more.  
23 There is no reason that anybody that is thinking about  
24 private offerings wouldn't feel that the, you know,  
25 existence of a freely tradeable security was a benefit."

1 That said, there are some differences in the  
2 way that private offerings are negotiated, and you know,  
3 there are some differences there. So private investors  
4 often times will negotiate many, many different things  
5 into a private offering that would not perhaps be  
6 available on a -- but that really -- his response  
7 confirmed exactly what you and I think would be the case.

8 MR. GOMEZ: Steve, can I ask you a question?

9 CO-CHAIR GRAHAM: Please.

10 MR. GOMEZ: This probably for Brad. This  
11 committee has discussed the -- why is it that there are  
12 not as many IPOs for a number of meetings. At times  
13 they've heard that, potentially, just a \$50 million IPO  
14 or less is just not feasible any more. From the  
15 standpoint of your firm under the current landscape, is  
16 it that it's not feasible, is it that the companies are  
17 not there? Would you take a \$40 million IPO if it met  
18 otherwise your guidelines? Or are changes needed in  
19 order for that to be a profitable business for the firm?  
20 Is it just a lack of potential candidates because of more  
21 private capital and companies taking longer to get to you  
22 and say, "We want to do that IPO"?

23 MR. EICHLER: Probably the place that we see  
24 that the most is in -- you asked several questions, but  
25 probably the place we see it the most is in our

1 depository institutions practice, where we focus on  
2 community banks. And we would definitely do a  
3 transaction south of 50 million.

4 One of our most successful deals over the past  
5 couple years has been for a bank in Dallas called  
6 Veritex. It was a deal we spent a lot of time thinking  
7 about because we wanted to make sure they had a  
8 sufficient market cap at time of pricing to be in the  
9 Russell 2000, to qualify for it. But it was a small  
10 transaction for us, sub-\$200 million market cap at time  
11 of deal. But it's a company that has completed two  
12 acquisitions, done another \$100 million financing, the  
13 stock has doubled, it's turned out remarkably well.

14 So, for us, all of it is -- again, going back  
15 to the original comment of, you know, this is ultimate  
16 capitalism of trying to put together our corporate  
17 clients and our institutional and individual clients. At  
18 the end of the day, if we find a small company that we  
19 think is a great small company that we've known, we've  
20 spent time with, we like the industry, we like  
21 management, we like the financials, and we can make our  
22 clients money, that's great. Because all business is all  
23 about relationships. And if we burn any aspect of that,  
24 that goes away.

25 And so, it's just -- that's the driving force

1 for us. When we go in and we present, one of the things  
2 we talk about is the success of our transactions, how  
3 they've priced, how they've performed, because we think  
4 that's very important as it relates to your question.  
5 So, you know, performance drives -- and expectations of  
6 our performance -- drive attractiveness in smaller  
7 transactions.

8 CO-CHAIR GRAHAM: So, following up to that,  
9 how many transactions of that size have you done  
10 recently?

11 MR. EICHLER: It's been limited. You know,  
12 sub-\$300 million companies is probably a little bit  
13 broader set. I could come back with the exact data, but  
14 outside of depository institutions it's been very  
15 limited.

16 CO-CHAIR GRAHAM: Because your response  
17 seems to suggest that the issue has more to do with just  
18 kind of, you know, being mindful of your relationships  
19 and finding the right companies to put in front of your  
20 investor clients, which leaves out all of the ecosystem  
21 stuff that we've been talking about.

22 And so, I'm just kind of guessing that it's  
23 more -- there is more to it. And -- as far as bringing  
24 back the smaller IPO, there is more to it than just  
25 simply finding the right company to match with the right

1 investors.

2 MR. EICHLER: Well, I mean --

3 CO-CHAIR GRAHAM: Because you have to make  
4 money for one thing, don't you?

5 MR. EICHLER: Excuse me?

6 CO-CHAIR GRAHAM: I said you have to make  
7 money, for one thing, don't you?

8 MR. EICHLER: Yeah, but -- you know, but that's  
9 gone down. That's gone down dramatically.

10 But what I would say is we're out constantly  
11 talking to small businesses about going public. And you  
12 know, one of the things that they're very focused on is  
13 what are the different alternatives in the market --  
14 going to one of my first points about private equity,  
15 venture cap, family office money, et cetera. And so,  
16 there is a decision that's binary that they've got to  
17 make as to what path they want to head down.

18 But I think the point of it is, in the case of  
19 a bank like Veritex, it's been very successful. It's a  
20 small cap IPO, and it's been successful for all parties  
21 involved. So we're up there constantly trying to find  
22 those companies, it's just a question -- which is really  
23 a company question -- what's the path that they want to  
24 head down, ultimately. Is it a path of an M&A  
25 transaction, or is it a path of an IPO?

1 CO-CHAIR GRAHAM: I'm wondering if the bank  
2 experience is different from, let's say, the small  
3 technology company or small biotechnology company, in  
4 terms of liquidity, in terms of need for additional  
5 capital, in terms of, you know, the -- I guess in that  
6 regard the need for sizeable follow-on offerings, and  
7 that sort of thing.

8 But it sounds like what you're saying is that,  
9 with the current state of the markets, the current  
10 character of the markets, finding the right companies,  
11 you feel that it's -- that the smaller size of an IPO  
12 isn't necessarily an impediment to getting that done.

13 MR. EICHLER: That would be correct, yeah.

14 MR. YADLEY: Rob has said that they do best  
15 efforts underwritings. I assume that's the same for you  
16 all, too?

17 MR. EICHLER: Correct.

18 MR. YADLEY: I mean, Steve and Sara, I mean  
19 that seems to be an area that we haven't really talked  
20 about, which is liability. And part of the reason is --  
21 because we're not talking about firm commitment  
22 underwritten offerings. And it seems like there is some  
23 dovetailing there between a good company and good  
24 investors and how do you match them.

25 And it occurred to me, when we were talking

1 were talking about the kind of context of Reg A+ and  
2 institutions, and I think you said something along the  
3 lines of, you know, it's fixed price and they don't get a  
4 lot of input into valuation. And I was thinking through  
5 your case studies, and you noted that not every one of  
6 the case studies included a broker-dealer intermediary.

7 And so I'm thinking it was part of the reason  
8 that some of these transactions are not getting consumer  
9 support or even initial support is that you don't have  
10 the typical pulling-through of the valuation before the  
11 valuation is announced by the company. Because I'm  
12 seeing -- or at least I think I'm seeing -- some of these  
13 companies just creating valuations on their own accord,  
14 without the typical diligence or, you know, critical  
15 feedback support that we see in the public market.

16 So I just wonder if you think that's a  
17 challenge, also, that comes to choosing not to use a  
18 broker-dealer intermediary to do a higher level of  
19 diligence or a higher level of valuation support, and  
20 that actually could be another issue facing the companies  
21 trying to raise the capital this way.

22 MR. MALIN: Absolutely, we couldn't agree more.  
23 I think Elio is a good example, where there was really no  
24 outside validation of the price at which that came to  
25 market. They enjoyed a tremendous run-up immediately

1 about some of the demand out there, and the difference  
2 between a Reg A+ IPO and a private placement -- talked  
3 about Series A and Series B, Steve -- part of it is, if  
4 Goldman Sachs is doing the private placement, everybody  
5 wants to get in on it because it's Goldman Sachs. And  
6 this other case, you might have a broker-dealer  
7 intermediary, including quality folks like Hambrecht,  
8 that are trying to help them do stuff. And it does seem  
9 illogical that people who are buying the beauty products  
10 and know the company -- and now you've vetted it, and  
11 there is information, and it is publicly available --  
12 that that connect wouldn't be there. And yet, private  
13 equity funds continue to raise money.

14 I think part of it, as crazy as it sounds, is  
15 it's almost too democratic. And you can get into it, and  
16 so, well, maybe I'll pass. That's maybe a little bit  
17 cynical, but that -- I sort of have that thought going  
18 through my head here.

19 CO-CHAIR GRAHAM: Like any club that would  
20 accept me I don't want to --

21 (Laughter.)

22 MR. YADLEY: Yeah, that.

23 CO-CHAIR GRAHAM: Okay. Any other  
24 questions? Yes, Annemarie?

25 MS. TIERNEY: Just one. I was thinking -- you

1 after the offering, partly because there was not a whole  
2 lot of securities available for sale. But now, I think,  
3 as its become public knowledge that there is, you know,  
4 subsequent financings that are required for success of  
5 that company, the valuation has suffered.

6 And so, we've tried to address that problem in  
7 a variety of ways. So for Reg A+ deals, including the  
8 one that we're working on currently, we won't seek  
9 qualification and final pricing until we've done an  
10 extensive test-the-waters pre-marketing campaign, and  
11 effectively built a book of indications, where we have  
12 some real view on market receptivity for the securities  
13 at a particular price. So I think that makes sense.

14 Where that breaks down is if you wish to engage  
15 the broadest possible community over a longer period of  
16 time. You can't make those sales until you're qualified,  
17 and so you have to pick your price and be qualified.  
18 And, for better or for worse, you live with that price.

19 So, again, if you determine you're going to  
20 attempt to engage institutions, once you've chosen a  
21 price that can be more challenging. No question. And  
22 that -- so it's not an insurmountable challenge, because  
23 you can structure these in different ways, and rely on  
24 that feedback. So we're talking to a company right now  
25 about what we'll call a hybrid offering, where they seek



1 to have a longer, continuous capital-raising period from  
2 a broad community of investors. But we feel that they  
3 can do that most effectively if they have an initial  
4 investor -- hopefully, a sophisticated professional  
5 investor -- that expresses an opinion at the outset and  
6 invests money, perhaps enough to meet the minimum, at the  
7 beginning of that transaction. And then they can attract  
8 additional money.

9 So there is validation, often times, from a  
10 professional, sophisticated investor, and then that  
11 allows the broader community of investors to say, "Boy,  
12 this is a good deal. I'm getting in on the same terms as  
13 XYZ institutional investor, it's been vetted by an  
14 underwriter," et cetera, et cetera. But that price  
15 validation is an important component.

16 CO-CHAIR GRAHAM: Well, I think we should  
17 move on. Rob, Brad, this has been very helpful. Thank  
18 you very much for taking the time and speaking with us.  
19 I think we could probably continue the conversation, but  
20 tick size is beckoning.

21 (Laughter.)

22 MR. EICHLER: Thank you very much.

23 (Audio interference.)

24 MR. SHEPARD: -- detail. As that process  
25 progressed, I think the focus of the pilot really was

1 three buckets where the pilot really tests the movement  
2 from a penny to a nickel. So it's -- what will moving to  
3 a nickel do? And it -- and the three groups really test  
4 that nickel increment under, you know, incrementally  
5 rigorous restrictions.

6 So the first bucket really just requires, you  
7 know, quoting in minimal nickel increments. And that  
8 really is modeled quite closely on the structure we have  
9 for the minimum penny-trading increment today, in that we  
10 require orders that are submitted to a market, accepted  
11 rank or display to be in the minimum trading increment,  
12 but we do not preclude over-the-counter market makers,  
13 for example, from executing with price improvement that  
14 are within those increments.

15 So, first group, same thing. Can't quote in  
16 increments of less than a nickel. But over-the-counter  
17 market makers are still free to offer price improvement  
18 within that minimum increment. And there is a midpoint  
19 restriction there, as there is in the current structure.

20 The second test group takes this one step  
21 further, and does place restrictions on the minimum  
22 trading increment, and basically says minimum trading  
23 increment is a nickel, as well as the minimum quoting  
24 increment. That helps to level the playing field a bit  
25 between the over-the-counter market makers and exchanges

1 more on the market quality issues. Although there were  
2 some that thought there could be a connection between  
3 tick size and IPOs, research, many thought that was  
4 tenuous, and it would be more productive in the first  
5 instance to look at the impact on market quality.

6 The U.S. is unusual in the sense that it has a  
7 minimum tick size for everything over a dollar of a penny  
8 across the board, regardless of price, regardless of  
9 liquidity. Other jurisdictions do it differently. And  
10 it certainly is colorable that there would be room to  
11 have a better system of tick size in the U.S. So we --  
12 the Commission and we thought it may be a very worthwhile  
13 effort to undertake.

14 So the -- as was mentioned, we approved the  
15 plan for the tick pilot in May of 2015. It was  
16 implemented last October, so we were about 8 months in.  
17 It's a two-year pilot. The group of pilot securities is  
18 really small and midcap. It's larger -- includes  
19 companies larger than the ones that you focus on, so that  
20 the criteria are \$3 billion or below market cap, a \$1  
21 million share average daily trading volume or less, and  
22 \$2 in price or more.

23 There are about 2,400 of those securities,  
24 pilot structures -- half -- about half are in a control  
25 group, no changes. And the remaining half are split into

1 and ATSS, in that they are less free to offer  
2 sub-increment price improvement. There is a limited  
3 exception for retail orders, which can be price-improved  
4 in increments of up to -- of half a penny, and that  
5 mirrors a mechanism that is currently in place for  
6 exchanges to offer, sub-increment price improvement for  
7 retail orders. So there is some flexibility. But  
8 over-the-counter market makers are more restricted in  
9 test group two than in test group one.

10 Finally, test group three, which, as you know,  
11 was the most controversial, introduced the trade-at  
12 requirement, and that builds on test group two, and  
13 really focuses on, you know, incentives to display  
14 liquidity. What's the potential impact of increasing the  
15 trading -- minimum trading increment on displayed  
16 liquidity? It essentially prevents price matching, and  
17 effectively requires anyone who wants to trade at the  
18 minimum trading increment to display a quote in the size  
19 they want to trade on an exchange. So, again, as we're  
20 leveling playing fields, this pushes it one notch in  
21 favor of, you know, displayed exchanges a variety of ways  
22 to test potential impacts of increasing the trading  
23 increment from a penny to a nickel, controlling for  
24 various factors.

25 So that's the pilot. I'm not sure -- we're

1 about eight months in. The pilot data that is being  
 2 collected is quite granular: order-by-order  
 3 market-quality statistics. It also includes information  
 4 on market-maker participation, profitability. That data  
 5 was -- it's produced -- it's currently being collected.  
 6 Baseline data was collected beginning six months prior to  
 7 the introduction of the pilot, and will be collected six  
 8 months after. Regulators have it now. It's not yet  
 9 publicly available. The intent was to have it publicly  
 10 available by now. But there are concerns, because it is  
 11 so granular that it could actually reveal information  
 12 about particular market-maker and trading center  
 13 activities.

14 So, the way that's been addressed, first of  
 15 all, is four-month-delayed before it's released. But the  
 16 most recent change, which was just approved by the  
 17 Commission, was to release that data in buckets. So it's  
 18 still order-by-order, but there are buckets of at least  
 19 five trading centers, so that it would make it very  
 20 difficult to reverse-engineer in order to implement that  
 21 latest change, that -- that the more granular tick pilot  
 22 data will be available towards the end of August.

23 So, with that, I will turn it over to people  
 24 who can actually do something with the data. So why  
 25 don't I turn it over to David?

1 MR. SHILLMAN: Thanks, Dave. So, as Dave  
 2 mentioned, there have been a number of market  
 3 participants that have put out studies or briefings about  
 4 what they've observed from the publicly-available data  
 5 thus far. The SEC is also monitoring the pilot using  
 6 these same data sources. We haven't said anything public  
 7 about it. So what I will talk about here are some of the  
 8 metrics that some of these market participants have  
 9 cited. I will say that, in general, what the SEC is  
 10 seeing is wholly consistent with these observations, with  
 11 a couple of exceptions, and I will note those in a few  
 12 places.

13 So, just walking through some of the metrics  
 14 that were of interest when the pilot was introduced, and  
 15 which market participants have continued to focus on, one  
 16 where I think people have been a bit surprised is volume.  
 17 There has been no notable change in volume in the control  
 18 group or the test groups. Some of these studies have  
 19 suggested that they observe larger trade sizes, larger  
 20 average trade sizes, or more blocks. I would exercise  
 21 some caution on that, based on some challenges with the  
 22 data. And I think we will have to get a little bit  
 23 further into that before we can make some comments about  
 24 whether there really are larger trade sizes in these test  
 25 groups.

1 Spreads have widened, not surprisingly. When  
 2 you widen spreads, spreads widen. But there are a couple  
 3 of important caveats there, as well.

4 First of all, nearly all of the stocks were  
 5 already trading at more than a penny before the pilot  
 6 began. Many were trading at more than a nickel before  
 7 the pilot began. So what we've seen is that spreads  
 8 widen, particularly for the lower-priced stocks that  
 9 started less than a nickel. They've widened out a good  
 10 bit. The higher-priced stocks that started more than a  
 11 nickel, there hasn't been a whole lot of changes in the  
 12 test groups there.

13 With regard to depth, there is more depth at  
 14 the inside in the test group names than in the control  
 15 group names. There is some concern about using depth as  
 16 a good measure of the pilot, given the heterogeneity of  
 17 spreads within these stocks. You know, there was quite a  
 18 bit of variation within the stocks, even within the test  
 19 groups. There appears to be more "stability," which is  
 20 to say there are fewer changes per unit of time in the  
 21 test group stocks. And that's not surprising, given that  
 22 there is quite a bit of volume clustering around some of  
 23 these larger spreads, so it requires more volume to trade  
 24 to move a quote.

25 Some observers have said that they see more

1 volatility in the test groups. To the extent they do,  
 2 they do say this is short-term volatility, rather than  
 3 longer-term volatility. There is some evidence to the  
 4 contrary here, as well, and I -- you know, I think this  
 5 is a place where more analysis is going to be needed.  
 6 And I'm not entirely sure we have seen that in what we're  
 7 monitoring.

8 A big focus of most of these studies has been  
 9 to note that trading costs are apparently higher for the  
 10 test group stocks, and here again that can't come as a  
 11 huge surprise when you measure trading costs by wider  
 12 spreads, given that spreads have widen, trading costs  
 13 have gone up. They are also, you know, using other  
 14 measures of trading costs like market impact, cost of  
 15 immediacy. Those also seem to indicate higher trading  
 16 costs.

17 This, again, like the spreads and like depths,  
 18 appears to be more prevalent among the lower-priced  
 19 stocks in the test groups than the high-priced stocks.  
 20 But, you know, there is a higher cost of trade here,  
 21 which, you know, likely means somebody is making more  
 22 money. Whether it's the market makers or not is  
 23 something that, you know, Amy can talk about a little bit  
 24 more.

25 Finally, there has been a shift in where

1 trading takes place among the test group stocks. Almost  
 2 all -- well, all three of the test groups have shifted  
 3 away from maker-taker exchanges and more toward inverted  
 4 exchanges. Groups one and two have shifted more to ATSS  
 5 or dark venues. Group three, because of the trade-at  
 6 requirement, has shifted away from dark venues, and we're  
 7 seeing a lot more trading in lit venues for the group  
 8 three names. And one of the other things we see with the  
 9 group three names -- again, because of the trade-at  
 10 requirement -- is an increased use of intermarket sweep  
 11 orders.

12 A number of these studies that have come out  
 13 have raised concerns about information leakage along the  
 14 lines that Dave talked about already with the potential  
 15 release of additional data, but they've also highlighted  
 16 this group three, given that there is a lot more trading  
 17 in these lit venues, and there are wider spreads and  
 18 larger bid-ask volumes. And most of this, again, seems  
 19 to be speculation that there may be information leakage,  
 20 that this may be responsible for some of the higher  
 21 trading costs in test group three, and not a lot of data  
 22 around that thus far.

23 MS. EDWARDS: So, I think, you know, my first  
 24 point would be that, really, you know, we have a lot of  
 25 very interesting results coming primarily out of industry

1 studies at this point in time. But the analysis of the  
 2 tick size pilot is still in the very early stages.

3 Dave mentioned some SRO pilot data and the  
 4 availability of that, and the masking of that data. Most  
 5 of the SRO pilot data will not be available until August.  
 6 And that pilot data will be what's really needed to test  
 7 some of the deeper issues associated with the tick size  
 8 pilots. And I'd -- I guess I would say that, you know, a  
 9 lot of the analysis that would use the SRO pilot data  
 10 would supplement what we already know, but may take a  
 11 slightly deeper dive, and may be able to address a  
 12 different set of questions.

13 I think, in addition to the industry studies,  
 14 we're also aware of a few academic studies. Again, these  
 15 are still in their preliminary stages. Only a few have  
 16 been made public, and I believe they're in -- they're  
 17 still very preliminary. We expect to see a number of  
 18 other academic studies, particularly after the SRO data  
 19 becomes available.

20 DERA also is planning its own studies,  
 21 primarily using the SRO data. We have been studying it  
 22 thus far. We have not released any of our results  
 23 publicly at this point. But most of our analysis really  
 24 focuses on filling some of the gaps associated with what  
 25 we don't know so far from the industry studies, and

1 really getting to some of the main points that were at  
 2 the heart of why we're doing this tick size pilot. Is  
 3 there a way that we can tell who is profiting from the  
 4 tick size pilot? Can we try to disentangle some of the  
 5 effects and really get at what some of the economic  
 6 effects would be of changing the tick size for all or  
 7 some of the stocks that are in the pilot?

8 We would be focusing on hypothesis testing.  
 9 Most of what we've seen so far looks at pictures and of  
 10 whether the pictures seem to show a big change or not.  
 11 We would look at hypothesis testing that tells us a bit  
 12 more about what's going on, and whether those changes are  
 13 really normal variation or if they are statistically  
 14 significant.

15 And I think we would also really try as hard as  
 16 we could to get to the capital formation point, or as  
 17 close as we can to that. And I think addressing market  
 18 maker behavior and market maker profitability is a key to  
 19 that. I think if market makers are going to try to  
 20 encourage additional trading, or new issues in some of  
 21 these stocks, then you need to see their behavior change  
 22 first. And so, we're particularly interested in some of  
 23 those results.

24 We're also interested in identifying whether  
 25 there is a natural threshold. David mentioned that some

1 of the effects seem stronger for lower-priced stocks, or  
 2 stocks that were trading below a nickel prior to being  
 3 entered into the pilot. And so we will look at different  
 4 ways of cutting the stocks to see if there are natural  
 5 break points where having wider tick sizes makes more  
 6 sense, or may, you know, pass a cost benefit comparison.  
 7 And I think a lot of this will really naturally lead into  
 8 a debate.

9 Like I've said before, we have not publicly  
 10 released any analysis. We do intend to publicly release  
 11 analyses as we complete them.

12 Yeah, in terms of timing, I would say that  
 13 about maybe about 11 months the self-regulatory  
 14 organizations are going to be submitting an assessment of  
 15 the pilot to the Commission, and publicly. And I think  
 16 the -- probably the months that follow that assessment  
 17 will be heavy months for really digging into all the  
 18 results at that point in time and figuring out what to  
 19 do, at least, you know, in terms of the public debate  
 20 associated with the tick size pilot. And so, our goal is  
 21 to get our analyses out before then. Thank you.

22 CO-CHAIR GRAHAM: So, stay tuned, I guess.  
 23 (Laughter.)

24 CO-CHAIR GRAHAM: Is there -- I mean,  
 25 recognizing, you know, where you are in terms of analysis

1 and state of the study, and also understanding you --  
2 can't hold you to anything, have you -- beginning to --  
3 do you have any sense for what your conclusions might be?  
4 Do you have any sense for kind of a bottom line? Do you  
5 have a sense for whether this is even useful because it's  
6 something that's being done in isolation, and -- while  
7 nothing else that adversely affects the ecosystem is  
8 being done? Is this a little bit like treating a patient  
9 with multiple issues, and you just treat one issue and  
10 expect the patient to get well? You can --

11 MS. EDWARDS: Those are good questions. I  
12 think we have designed the pilot in a way that I think  
13 gives us the best opportunity to get answers we can rely  
14 upon. I think it is too early to know how -- what the  
15 answers will end up being, particularly if we kind of  
16 open ourselves up to the idea that the answers could be  
17 different for different stocks. And I think I have hope  
18 that we will come up with those answers, but I don't know  
19 what those answers are going to be at this point in time.

20 CO-CHAIR GRAHAM: Yeah, I've -- because I  
21 guess I understood that, I was just kind of wondering  
22 what your sense was, if you -- but maybe you have told  
23 me.

24 Other questions, anyone?  
25 (No response.)

1 CO-CHAIR GRAHAM: Okay. Then thank you for  
2 that interim update, and we look forward to the summer.

3 We are suddenly ahead of schedule. So should  
4 we just break? All right, so we'll just break early for  
5 lunch and reconvene at 1:30.

6 (Whereupon, at 11:48 a.m., a luncheon recess  
7 was taken.)

8 AFTERNOON SESSION

9 CO-CHAIR GRAHAM: It's after 1:30, so why  
10 don't we get started? And, with that, I'll hand it off  
11 to Sara.

12 CO-CHAIR HANKS: Well, it's true to say  
13 that, from the very first meeting of this iteration of  
14 the committee back in February 2016, we've been eager to  
15 obtain more data to help evaluate what policies and  
16 safeguards are effective in facilitating capital  
17 formation. And data has been one of the continuing  
18 themes, I think, of this committee.

19 We've discussed the significant difference that  
20 exists between protecting investors from fraudsters  
21 versus preventing them from being able to put their money  
22 into an investment that could lose money. I think all of  
23 us are amenable to protections that help prevent Grandma  
24 from turning her retirement nest egg over to a scam  
25 artist. But at the same time, the SEC is not a merit

1 regulator, and we shouldn't support measures that block  
2 would-be investors out of certain investments, just  
3 because of their risk.

4 Every year NASAA publishes an enforcement  
5 report based on the prior year's data. The data  
6 statistics and trends included in the recent 2016 report  
7 give a good general overview of the state enforcement  
8 efforts in 2015. And we thought it would be good to get  
9 a briefing on what the states are seeing and the data  
10 that they're able to provide. Mike, thank you very much  
11 for agreeing to lead the discussion on this.

12 MR. PIECIAK: Yes, Sara, my pleasure. And  
13 please feel free to jump in and ask any questions  
14 whenever the questions arise.

15 But just to piggy-back on Sara's point,  
16 yesterday we had our annual 19-D conference between the  
17 SEC and the states. And again, one of the three main  
18 takeaways I think probably everybody had was that data  
19 and data collection are so important, to be making  
20 data-driven decisions, and not to be making sort of  
21 gut-level decisions or anecdotal decisions, as well,  
22 which -- you know, and being a state regulator myself, I  
23 do see sometimes the anecdotal, you know, decision-making  
24 that can creep in to, you know, people's thoughts. And  
25 you do have to try to resist that and have it be more

1 data-based.

2 So, the report, as -- well, actually, before I  
3 get into the report, I'll just give a -- just for  
4 everyone's benefit -- and some probably have heard me say  
5 this before and some haven't, but, you know, the states,  
6 for the most part, have a dual regulatory mission: on  
7 the one hand, protecting investors, on the other hand  
8 creating efficient capital markets, supporting capital  
9 formation, and the like.

10 So, I have sort of a tilt that is more toward  
11 the capital formation side of that balance. But that  
12 being said, and with that viewpoint, I think the  
13 enforcement and the investor protection is of the utmost  
14 importance, not just for the individuals, but also for  
15 the capital markets and the integrity of the capital  
16 markets, as well.

17 Just for an example, you know, if in the  
18 Regulation A or the crowdfunding space fraud becomes  
19 prevalent or rampant, you know, the success of those  
20 markets will be deterred greatly, and particularly new  
21 markets. So I think the enforcement efforts and the  
22 investor protection efforts are really critical for the  
23 capital formation in striking the right balance.

24 So, NASAA is an organization of state  
25 regulators for those that don't know. We have the 51

1 jurisdictions, which includes D.C., a couple of other  
2 territories, and then we have the Canadian provinces, as  
3 well. This enforcement report focuses on the U.S.  
4 jurisdictions.

5 And just to talk a little bit about the data  
6 before going into the data and what makes up the data, so  
7 every year we do an enforcement survey. We look at the  
8 previous year. So this 2006 enforcement survey is  
9 talking about the reporting from 2015. Right now we're  
10 currently engaged in collecting data from 2016, which we  
11 will put out in September of 2017. So the information --  
12 you know, there is a little bit of a lag time as we  
13 collect from our states and then analyze and put the  
14 report together.

15 We had, in this report, a -- I think a  
16 51-jurisdiction response rate, which is like, you know,  
17 96, 97 percent. So it's a really good response rate.  
18 But, that being said, there are some jurisdictions that  
19 didn't respond. And then also there are specific  
20 questions that are asked in the survey, and not all  
21 states keep their information in a certain way that's  
22 accessible to them.

23 So, for example, one of the questions we have  
24 in here is how many senior -- how many of your frauds  
25 that you brought enforcement actions against included

1 seniors. And some states include that data in their  
2 normal processes, and some states don't. So some of the  
3 data points, you know, are missing there. And to Sara's  
4 point about data, we are continually trying to improve  
5 our enforcement survey to collect data in a way that's  
6 most useful for us and for the public at large.

7 So, with that, I think maybe I will turn in to  
8 the results of the 2016 report. At a very high level we  
9 had -- first, looking at sort of the number of  
10 investigations, the number of actions, and then the  
11 results of those investigations and actions. In 2015 we  
12 had about 5,000 open investigations. This does not  
13 include numerous -- you know, probably more numerous  
14 account times where state regulators have informally  
15 resolved complaints against individuals or firms.

16 But the 5,000 figure is pretty consistent with  
17 the recent history. I went back and looked at our 2014  
18 through '9 reports, and we have had a trending downward  
19 number of investigations since the height of the  
20 financial recession. In 2009 we had 6,500 open  
21 investigations that year. And again, trending downward  
22 to last year we had 4,800 and this year we have about  
23 5,000. So it's pretty consistent with the recent past of  
24 the surveys, and certainly shows a downward trend from  
25 the financial recession, which, you know, I think is

1 probably consistent with what people would expect.

2 Regarding enforcement actions, we brought over  
3 2,000 enforcement actions. Most of the enforcement  
4 actions were brought administratively, as opposed to in a  
5 civil court. You will see, I think, on page -- I think  
6 it's page three -- and the reports were passed out -- or  
7 maybe it's page two you see the number of the enforcement  
8 actions. So the enforcement against, again, were  
9 trending down. There was a high of 3,500 in 2010, and  
10 every year that dropped by a few hundred. Last year we  
11 had 2,000 enforcement actions, as well as 2,000 this  
12 year.

13 So again, in a normal sort of economy, a  
14 normal -- you know, a normal market environment, these  
15 numbers have been pretty consistent, year over year. So  
16 nothing there that points out to me.

17 In terms of the results, NASAA members or state  
18 regulators obtained relief of about 800 million this  
19 year. Most of that was restitution, as you see on the  
20 second -- the page following, page number three. The  
21 \$538 million of restitution to investors, you know, is  
22 what we really look at, and what I look at as a state  
23 administrator. Returning money to investors that are  
24 harmed is of significant importance to us, and something  
25 we put at the top of our agenda, way above administrative

1 fines or penalties to our state or to our department.  
2 You know, getting restitution to those that were harmed  
3 is, I think, of utmost importance to every state  
4 regulator.

5 So, looking at that for a minute, I looked back  
6 at some of our recent enforcement surveys, and found  
7 that, again, not surprisingly, during the height of the  
8 financial recession state regulators really brought in a  
9 tremendous amount of money back to investors. In 2009  
10 the number was 4.7 billion. In 2010 it was 14.1  
11 billion -- those are with B's. In 2011 it was 2.2  
12 billion. A lot of that money made up the so-called --  
13 the option rate securities cases that were filed by state  
14 regulators and the SEC starting in about 2008 through  
15 2011. But also a number of those cases did not involve  
16 the option-rate securities. And you see also in 2012 we  
17 had about 700 million returned to investors.

18 So again, the numbers were trending downward,  
19 in terms of restitution, but that's consistent with the  
20 number of investigations and enforcement actions, as  
21 well.

22 The one thing that stood out to me was that, in  
23 terms of restitution, and in terms of penalties in 2015,  
24 there was a tick upward that was pretty significant. We  
25 had returned about \$405 million to investors last year,

1 and again the numbers this year are 538. So a  
 2 significant increase, year over year.  
 3 Additionally, the number of fines and penalties  
 4 that we were able to obtain were the highest since 2009,  
 5 when they were about 245 million. So an increase there,  
 6 in terms of restitution and penalties for investors.  
 7 CO-CHAIR HANKS: Michael, could I interrupt  
 8 on that?  
 9 MR. PIECIAK: Yes.  
 10 CO-CHAIR HANKS: With respect to  
 11 restitution, et cetera, is this actual dollars back in  
 12 the pockets of investors, or dollars ordered to go back  
 13 to investors? And do you keep those numbers separately?  
 14 MR. PIECIAK: Yeah, that's a great question.  
 15 When we fill out this report, we do dollars back to  
 16 investors. We often times will have the checks come to  
 17 us and we relay them to the investors themselves, so we  
 18 can be confident, you know, in our numbers. I can't say  
 19 that every state does it the same way. But I think, on  
 20 the whole, these numbers represent actual numbers and not  
 21 sort of numbers on paper. Yeah.  
 22 CO-CHAIR GRAHAM: And what is your sense  
 23 that -- I mean as to what these numbers say, from the  
 24 standpoint of -- it seems like the numbers are going up.  
 25 Does that -- do you feel that instances of fraud are

1 going up? Or do you just -- this is just more aggressive  
 2 enforcement?  
 3 MR. PIECIAK: Well, I think if you look at the  
 4 investigations and the enforcement actions, I mean, those  
 5 consistently have been trending downward, and this year's  
 6 report is consistent with last year's report. It's just  
 7 that the restitution and the penalty numbers have gone  
 8 up. So that could be an anomaly. We'll look at the data  
 9 that comes in in September for this current or this past  
 10 year.  
 11 But -- so based on the number of investigations  
 12 and enforcement actions it wouldn't tell me that fraud is  
 13 up. It would probably tell me that there were a number  
 14 of cases that either were egregious or, you know, the --  
 15 or just larger in dollar -- total dollar number this  
 16 year.  
 17 So the one last thing I want to point out in  
 18 terms of the overall picture, and then we can go in and  
 19 look a little bit more at the data from 2015. But the  
 20 last piece that's also important that is somewhat  
 21 licensing, somewhat enforcement, but the states also do a  
 22 good job and have at the top of our importance agenda of  
 23 gatekeeping who gets in to the industry and who remains  
 24 in the industry.  
 25 So this last year, about 3,000 individuals had

1 applied for registration, withdrew their registration. I  
 2 can't say that 90 or 100 percent of them were because  
 3 they wouldn't have been registered, but a pretty large  
 4 percentage of them would have had issues being registered  
 5 in the jurisdictions where they're attempting to. And  
 6 that number is pretty consistent with past reports.  
 7 Similarly, about 500 individuals were denied or  
 8 suspended, or their registrations were somehow  
 9 conditioned. And then 250 individuals were either  
 10 revoked or barred from the industry all together. So  
 11 again, another type of relief that state regulators look  
 12 for, and the SEC, as well, in terms of protecting the  
 13 capital markets and protecting retail investors, as well.  
 14 So, looking at the 2016 report, we also ask our  
 15 jurisdictions what are the most cited products and  
 16 schemes, in terms of the frauds that you see and the  
 17 enforcement actions that you've taken. This year the top  
 18 products, number one, were non-traded REITs. I think, in  
 19 terms of products, number one, were non-traded REITs.  
 20 And then oil and gas investment programs, annuity  
 21 products, life settlements, viatical settlements. So  
 22 that is pretty usual, those types of products we see  
 23 often at the top of the list.  
 24 The one thing that stood out to me was that in  
 25 the recent past, in 2014, '13, and '12, I think either

1 number 1 or number 2 in our products were 506 offerings,  
 2 private-placement offerings -- and they didn't make the  
 3 top list this year. I know they certainly are -- I know  
 4 they are still -- we see a number of cases revolve in  
 5 private placements and 506, but that was one thing that  
 6 stood out to me was at least it didn't make the top 5  
 7 list this year.  
 8 In terms of types of schemes, nothing that  
 9 probably surprises anybody. Ponzi schemes were number  
 10 one. Internet frauds and definitely frauds. And there  
 11 are some cases in the back that we can just sort of  
 12 highlight about, some of the more egregious examples that  
 13 we have seen related to those products and/or scams.  
 14 PARTICIPANT: Michael?  
 15 MR. PIECIAK: Yes?  
 16 PARTICIPANT: What's affinity fraud?  
 17 MR. PIECIAK: So --  
 18 PARTICIPANT: What's it -- what do you mean --  
 19 MR. PIECIAK: Yeah, so affinity fraud is, you  
 20 know, in the most broad sort of definition, is when a  
 21 fraudster takes advantage of victims based on some sort  
 22 of connection or affinity that they have with the  
 23 individual. So it could be based on going to the same  
 24 church, or having your -- you know, being of the same  
 25 ethnicity, or being in the same social group. So it's

1 some sort of affinity that you have with the social  
 2 circle.  
 3 And why they're so prevalent, I think, is  
 4 because you break -- when you have that connection -- I  
 5 mean Bernie Madoff was often thought of as an affinity  
 6 fraud fraudster because he preyed on the Jewish community  
 7 and, you know, he was Jewish himself, and that sort of  
 8 created a sense of trustworthiness among his victims. So  
 9 that's why affinity fraud is often at the top of the  
 10 list. Yeah.

11 So, in terms of the victims, I just want to  
 12 mention a little bit about this, as well. And, you know,  
 13 we've mentioned it, and Sara mentioned it in her opening  
 14 remarks, but seniors is -- senior issues and senior  
 15 financial fraud is a growing issue in this country. You  
 16 know, from the Investor Protection Institute, they have  
 17 estimated that one in five individuals over the age of 65  
 18 have fallen victim to some sort of elder financial abuse  
 19 fraud scam.

20 Another literature that is out there says that  
 21 only 1 in 44 elder financial abuse cases are actually  
 22 reported to some law enforcement or regulatory authority.  
 23 So we know the numbers are extraordinarily high -- I mean  
 24 1 in 5 over 65 is really high -- and that they may be  
 25 vastly under-reported, as well.

1 So, state regulators, the SEC, and others have  
 2 taken a real interest in protecting the senior community.  
 3 One, they might be the most vulnerable, because they may  
 4 not -- either lack some of the sophistication to know  
 5 when a product is fraudulent, or they may be having some  
 6 mild cognitive impairment that clouds their judgement,  
 7 particularly in terms of financials and their own  
 8 personal finances.

9 Just as sad is that, often times, they don't  
 10 have the time on their side to make up for investments  
 11 that have been lost. So that's why state regulators, the  
 12 SEC, have focused so much on protecting vulnerable  
 13 adults.

14 In terms of the data, we see that one-third of  
 15 the investigations this year have involved a senior  
 16 victim. That is up from last year, about one-fourth of  
 17 the cases involved a senior. A couple of years prior to  
 18 that, the numbers were hovering around 20 percent, or one  
 19 year was 14 percent. So at least from our -- you know,  
 20 we know this from other literature, but I think our  
 21 enforcement survey bears this out, that the prevalence of  
 22 senior frauds has increased over the last few years, and  
 23 the issue is probably getting worse, and not better.

24 MS. MOTT: Michael, I want to make a comment on  
 25 that, because I've just had experience with my parents

1 and having to take over their financial activities. And  
 2 the materials that they are providing are tremendous. I  
 3 had a problem in determining whether -- was this  
 4 something that my parents owned or not, and I had to get  
 5 attorneys involved. And they were all fraudulent.

6 MR. PIECIAK: Yeah.

7 MS. MOTT: So it's -- the expertise that they  
 8 are pursuing, you know, it is quite tremendous, even for  
 9 sophisticated people. And I can't imagine what they do  
 10 for unsophisticated.

11 MR. PIECIAK: Yeah. I mean both -- I mean they  
 12 are so prevalent, the numbers of frauds, but then also  
 13 they're resilient. Because one, you shut down one type  
 14 of fraud, or you make it known that some sort of scheme  
 15 is fraudulent, they come up with another scheme that's  
 16 even better and more easily able to fall for it.

17 So one of the things, you know, we have done in  
 18 Vermont and other state regulators have done is tried to  
 19 break down the stigma of being a victim of elder  
 20 financial abuse. One of the reasons why the -- there is  
 21 such great under-reporting, both seniors may not know  
 22 they've ever been a victim, but secondarily, they may  
 23 feel a sense of shame and embarrassment if it turns out  
 24 that they were a victim.

25 So, by trying to explain that, you know, anyone

1 can fall victim -- and the literature will actually bear  
 2 out that males between the age of -- you know,  
 3 highly-educated males between the age of, like, 45 and 55  
 4 or something are the most likely to fall for finance  
 5 scams, I guess because they over-exaggerate their own  
 6 ability to differentiate. But -- so, you know, you try  
 7 to get information out about how to break down that  
 8 stigma and increase reporting, so that state regulators  
 9 can get the information out and stop frauds and make the  
 10 community better educated.

11 The other thing that NASAA has been doing is  
 12 trying to create regulation that will help seniors and  
 13 partner with the broker-dealer investment advisor  
 14 community. So I think it was last year we passed the  
 15 Model Act, the Senior Model Act, and we adopted it in  
 16 Vermont. And it is a mandatory reporting act, on the one  
 17 hand. It requires those that handle broker-dealers and  
 18 investment advisors in our state to mandatorily report  
 19 either to the Department or the adult protective services  
 20 if they think one of their clients is the victim of elder  
 21 financial abuse. It also provides them immunity, so in  
 22 the event that, you know, it bears out that it wasn't the  
 23 case, they're not going to face repercussions from their  
 24 client or others that they informed the Department.

25 But then, more importantly, it allows the delay

1 of disbursement from the brokerage account or the  
2 investment advisor account for a certain period of  
3 time -- I think it's up to 15 or 20 days -- while the  
4 Department investigates and while they conduct their own  
5 internal investigation. So we view this not as a  
6 burdensome regulation, but as a tool that the industry  
7 and the state regulators can use to work together,  
8 because once the money is out of an account, it's almost  
9 impossible to get it back. So this is, I think, a  
10 frontline tool for broker-dealers, investment advisors to  
11 put a stop right at the gate when they suspect one of  
12 their clients is the victim of elder financial abuse.

13 So it's been a -- we adopted it in Vermont.  
14 It's being adopted across the country. There is maybe --  
15 I think maybe around 10 or a dozen states that have  
16 adopted it, and the number is increasing. So it's a good  
17 tool.

18 MS. YAMANAKA: Michael, I just have a quick  
19 question. First, is there a way for us to get a copy of  
20 the survey?

21 MR. PIECIAK: Of this?

22 MS. YAMANAKA: Yes. Or not of the results.

23 MR. PIECIAK: Oh, the underlying results?

24 MS. YAMANAKA: Of the actual survey itself.

25 MR. PIECIAK: Oh, I would think so. I mean

1 unless -- I'll check with my colleagues at NASAA to see  
2 if there is some proprietary nature to the survey, but --

3 MS. YAMANAKA: Just because sometimes it's nice  
4 having that as the background. You can see how the  
5 questions were posed.

6 MR. PIECIAK: Oh, yeah. No, very much. When I  
7 looked at the results, I had to go back and check some of  
8 the survey questions myself.

9 MS. YAMANAKA: Right. And I'm not doubting the  
10 results at all, I just -- sometimes it's nice just to  
11 have the reference point.

12 And then do you guys ever put together the  
13 year-after-year or the year-over-year? I know you  
14 mentioned some of it, but I didn't catch some --

15 MR. PIECIAK: No, that's fair. And I -- in the  
16 previous reports, we did do the year-over-year. This  
17 year I didn't serve on -- I'm not involved in the  
18 enforcement section, and it looks like they changed the  
19 way in which they provided the reporting information. So  
20 I don't know why they moved away from that, but previous  
21 reports did have year over year. So if you go back to  
22 our 2015, '14, '13 report, which are all on our website,  
23 it would have the year-over-year data.

24 MS. YAMANAKA: Okay. And then, I just had two  
25 small additional things.

1 The -- on the sanctions, the license sanctions,  
2 just to put a reference with it, you know, almost 3,000  
3 withdrawn out of how many overall issued? Just so then  
4 it can be -- especially if we use some of this data to,  
5 you know, present to others, just to show that it's such  
6 a -- what the percentage is, that it's not just  
7 minuscule, but it is something that maybe we should just  
8 still pay attention to.

9 MR. PIECIAK: Yeah, sure, that's a good point.

10 MS. YAMANAKA: And then, on the definition, you  
11 hinted at this a little bit, but it is really hard to  
12 gather data state to state to state, because definitions  
13 and interpretations -- did you find that to be a  
14 tremendous issue, especially when it comes to legal side?

15 MR. PIECIAK: Well, I mean, it's certainly an  
16 issue, because we have -- it's really an issue because  
17 people -- you know, people keep their data in different  
18 ways, you know? And I think they try to find the lowest  
19 common denominator when they do the survey questions and  
20 look -- and analyze the results.

21 So, you know, for example -- and I can think of  
22 a dozen questions we'd like to ask in the elder financial  
23 abuse arena, but not everybody keeps the data in a way  
24 that it is easily accessible, so we try to ask the most  
25 basic question of how many enforcement actions involve

1 someone that was 65 years or older. But it is part of  
2 the -- it's part of the struggle of both crafting the  
3 survey questions and then also analyzing the results that  
4 come in.

5 MS. YAMANAKA: And then I guess I do have one  
6 additional one. So now you have this, you have the  
7 year-over-year. What do you do to work not only -- you  
8 know, NASAA and -- what are the next steps to reduce it,  
9 to make it better for the next year? And what other  
10 agencies do you involved?

11 MR. PIECIAK: No, it's a great question. So, I  
12 mean, we -- you know, we often put sort of the -- looking  
13 ahead, as well, like, you know, what we've seen in the  
14 last year, what we're looking out for and what not. I  
15 mean, clearly, when we look at the last four or five  
16 years, senior financial abuse has been a focus of ours.

17 So when you look at both the Model Act, like  
18 we've worked on and now working on implementing -- and I  
19 think that probably comes directly out of both anecdotal  
20 evidence that people are experiencing in their states,  
21 and also the enforcement survey -- we -- you know, if we  
22 see other trends, we have market -- you know, we have  
23 investor alerts, and things of that nature. And we also  
24 have enforcement conferences that allows those that are  
25 on the front lines to be aware of what the results are



1 and, you know, what to be looking for.  
2 In terms of working with other -- you know,  
3 other agencies, we certainly work as states, you know,  
4 collectively, particularly on things that are  
5 cross-border, which almost probably -- you know, a very  
6 high percentage of them would be. And then we also work  
7 closely with our federal counterparts, as well.

8 And, you know, we -- one example I was going to  
9 give was a case that we had in Vermont recently that  
10 started -- the investigated started in 2015, but it  
11 didn't get filed until '16, so it kind of is on both  
12 sides of this year's report and last year's report. But  
13 it was a, you know, equivalent of a Ponzi scheme, and we  
14 worked closely with the SEC. And it happened to be the  
15 SEC regional office in Miami. So we, you know, had an  
16 extraordinarily collaborative investigation. Each other  
17 bolstered each other's investigation. The outcome of the  
18 complaint was tremendously improved by that  
19 collaboration, and there was absolutely zero, you know,  
20 territorial or turf issues, or whatever.

21 And the fact that we were located in Vermont  
22 and the fraud was in Vermont but they were in Miami,  
23 again, provided us sort of boots on the ground to be able  
24 to do -- you know, relay some information and provide  
25 some context to things that they were looking at.

1 So those examples are replicated across the  
2 country between the SEC, the regional offices, and the  
3 state regulators. I can't speak for every regional  
4 center and every state, but I think most states have a  
5 pretty strong relationship, collaborative relationship,  
6 with their enforcement counterparts in the SEC.

7 So I think the last point to look at, in terms  
8 of the overall data information, is the type of  
9 respondent, and that is on page five. And again, this is  
10 one year-over-year statistic that's of interest. I don't  
11 know -- you know, we'll keep an eye on it as to what it  
12 means, because it's the first year where this has  
13 happened. You will still see that a large percentage of  
14 our respondents are either unregistered firms or  
15 unregistered individuals. But when you add up all of the  
16 registered people, it's actually the first year when  
17 we've had more enforcement actions against registered  
18 firms or individuals, rather than unregistered firms or  
19 individuals.

20 So, in the past, traditionally, you know,  
21 people that wouldn't be on anybody's radar because  
22 they're not registered with anyone are the ones that have  
23 been committing -- or at least the most investigations  
24 have been focused toward, and the most enforcement  
25 actions have been focused toward. This year, as a

1 departure -- and the numbers are rather close -- but as a  
2 departure, was actually registered individuals, rather  
3 than unregistered individuals.

4 The type of complaints that we would see  
5 against our registered folks are things like a breakdown  
6 in terms of their book and record-keeping requirements;  
7 breakdowns in suitability -- so placing products with  
8 investors that weren't suitable for them -- failure to  
9 supervise unauthorized trading; churning -- you know, the  
10 in and out of placements with great frequency -- selling  
11 away; and then outright fraud, as well. So that's just  
12 sort of a -- you know, we'll -- it's -- again, it's a  
13 shift in what we've seen in the last four or five years,  
14 so we'll keep an eye on that, and as to what that means.

15 Yes, Catherine?

16 MS. MOTT: I was just curious about what  
17 pattern do you see in 506 offerings. You know, are there  
18 any particular patterns or issues that you see around  
19 506?

20 MR. PIECIAK: Well, you know, 506 -- I mean  
21 they can be so -- they can be, you know, of many  
22 different sort of shapes and sizes. They can be -- you  
23 know, they can be purported to be 506 offerings that are  
24 over the Internet and are really an Internet scam, you  
25 know. They can be real estate programs, you know, and

1 they're done under a 506. So they can come in a lot of  
2 different shapes and sizes, so it's hard to sort of draw  
3 one conclusion or not.

4 If I were to sort of make the top line sort of  
5 analysis, I mean, the thing that's most interesting is  
6 that the 506 has fallen out of the top 5, as I mentioned.  
7 I don't think that means that it's not happening, I just  
8 think that it probably means there is some other -- you  
9 know, some other products that maybe this year were more  
10 significantly bad for investors. But, you know, they  
11 often are the -- they are often the sort of unregistered  
12 frauds, the unregistered individuals doing outright  
13 frauds and outright Ponzi schemes, I think, are the type  
14 of enforcement actions we see that involve 506.

15 MS. MOTT: So more unregistered Internet --

16 MR. PIECIAK: Yeah, and I mean, even just -- I  
17 mean and not necessarily just Internet, but the classic  
18 Ponzi scheme-type --

19 MS. MOTT: Okay. I'll tell you. I was  
20 involved in -- just last year with someone who used --  
21 who went out -- was raising money under a 506 offering,  
22 and said they received funding from us.

23 MR. PIECIAK: Yeah.

24 MS. MOTT: And they didn't. And -- but people  
25 invested because they thought -- now, if they'd done

1 their due diligence, they would have maybe -- they could  
2 see what we've invested in on our website, and things  
3 like that. But, you know, they didn't. They -- you  
4 know, so we were quite helpful with the prosecution on  
5 that. So --

6 MR. PIECIAK: Yeah, that's good. Well, thank  
7 you.

8 And just one other -- just as I think of it, I  
9 mean, the other thing we're going to be looking for,  
10 going forward, and maybe we'll see if we have it in this  
11 year's data, since 2016 will cover more of the timeframe  
12 when Reg A and crowdfunding has been in place, but, you  
13 know, to what extent we see any enforcement actions or  
14 investigations in that arena. Anecdotally, I haven't  
15 heard of any. But that doesn't mean that they haven't  
16 been happening.

17 PARTICIPANT: I commend every state's efforts  
18 to pursue fraud and unregistered personnel. You know,  
19 you and I have disagreed about transactional matters, but  
20 I applaud what you all do in the way of fraud  
21 prosecution. I think it's absolutely essential. And I  
22 can't say enough good about it. And there are a lot of  
23 widows and old folks that are getting taken advantage of,  
24 and lawyers who think they know more than they really  
25 know, even.

1 But one thing I would say about the bar, and  
2 that is that there are a lot of lawyers who don't even  
3 know what a security is. And I'm embarrassed to say in  
4 my home state of Texas that the state courts have a  
5 rather loosey-goosey pleading system, so there actually  
6 are trial -- a good number of trial lawyers who won't go  
7 into federal court. They just -- the rules are more than  
8 they want to put up with, which is an embarrassment.

9 But nonetheless, I hope that you will continue  
10 your education efforts -- and I'm speaking nationally.  
11 There are local Bar Associations that are also looking  
12 for continuing legal education credits and materials.  
13 And the opportunity for somebody like you to go in and  
14 speak to what is a security, and what are your remedies,  
15 and, by the way, we do private enforcement, too, would be  
16 a -- if you could increase the knowledge of the Bar, the  
17 private Bar, I think they would -- could be good friends  
18 for you in chasing the crooks.

19 MR. PIECIAK: Yeah. No, I think that's exactly  
20 right. I mean we -- I can only speak to what we do in  
21 Vermont. But, I mean, in the last six months or so I've  
22 spoken a couple of times to the Vermont Bar Association  
23 and at their annual conference and annual training. And  
24 we've been promoting some of the crowdfunding and local  
25 investing options that we have in the state, and also

1 informing people as to what the regime of the state and  
2 federal securities laws are, and how they operate,  
3 because I think often times lawyers will just stay away  
4 from it all together because it's too complex and they  
5 don't have the number of cases that they see in places  
6 like Vermont --

7 PARTICIPANT: I mean there are some big-dollar  
8 cases that never plead securities fraud that are brought  
9 as corporate law violations or brought as Deceptive Trade  
10 Practices Acts, or common-law fraud, and it's -- you  
11 just -- you're looking for the cause of action for the  
12 securities fraud, and it's just not there.

13 MR. PIECIAK: Yeah, yeah. That's a good point.  
14 And you also reminded me of something I didn't mention  
15 about the enforcement action is -- because Vermont  
16 doesn't have a criminal jurisdiction, but a number of our  
17 state regulators do have criminal jurisdiction, and  
18 usually, you know, they -- we do it by the number of  
19 years in jail obtained. And I think this year it was  
20 something close to 900 years in jail that were  
21 obtained --

22 (Laughter.)

23 MR. PIECIAK: And it seems like, from the  
24 breakdown, that's pretty consistent. But it's actually a  
25 rather small number of states, securities regulators,

1 that have the criminal jurisdiction. But those that do,  
2 you know, I know they use it judiciously, but they also  
3 get pretty strong results in very bad circumstances.  
4 So, on the -- toward the end of the report  
5 there are some examples of case highlights from 2015 that  
6 I just want to touch upon, because I think they help  
7 illustrate some of the schemes and some of the trends  
8 that we've been talking about. And I don't want to go  
9 into great detail, but, you know, in terms of -- the  
10 first one is highlighting the -- some Ponzi scheme cases.

11  
12 There is one that was from Texas, a \$37 million  
13 Ponzi scheme in pretty -- all the sort of -- the classic  
14 ideas that you would see there: promissory notes at a  
15 high rate of interest, they come in and the monies are  
16 used to pay back new investors, both in terms of this  
17 high interest amount and also to fund an extravagant  
18 lifestyle. Texas obtained a conviction in that case in  
19 2015, and I think it was 19 years in jail for the  
20 perpetrator. But that's sort of the classic vanilla  
21 Ponzi scheme.

22 One thing that Virginia did this last year,  
23 which is to highlight that they went against the firm of  
24 a registered individual that was conducting a Ponzi  
25 scheme outside of his normal business operations, for

1 failing to supervise that individual. So that's a sort  
 2 of a new flavor as -- on to the traditional Ponzi scheme.  
 3 Relating to the Internet fraud that Catherine,  
 4 you know, mentioned, this is one that we educate  
 5 Vermonters about, but the so-called sweetheart, or  
 6 romance scheme, you know --  
 7 PARTICIPANT: That's really affinity fraud.  
 8 MR. PIECIAK: Yeah.  
 9 (Laughter.)  
 10 MR. PIECIAK: Well, this particular case was a  
 11 male that had, over a 10-year period, I think, had a high  
 12 number of single women that he, you know, romanced over  
 13 the Internet, and he got them to invest in a -- you know,  
 14 an offering that he was conducting. And it was a fraud,  
 15 and it, again, financed his lifestyle, and what not. But  
 16 that's how we're seeing the use of the Internet more and  
 17 more, both in terms of postings on Craigslist, and things  
 18 of that nature, or the romance schemes, as people more  
 19 and more look to online dating services to find -- you  
 20 know, particularly those that are looking later in life.  
 21 So those are issues that we're trying to educate the  
 22 public about, as well.  
 23 Something else that we're seeing are the  
 24 gatekeeper frauds. So these are probably most  
 25 concerning. CPAs, estate planning attorneys. There is

1 examples of cases from 2015 that include them. Often  
 2 times we think of the gatekeepers as our front-line staff  
 3 to help us prevent abuse of elder victims or any victims.  
 4 But when they themselves are perpetrating frauds, those  
 5 are of serious consequence.  
 6 And then, of course, the senior frauds that we  
 7 touched upon. And there is one example in here of a \$13  
 8 million fraud in Minnesota that included 100 investors.  
 9 Most of them were elderly or otherwise vulnerable, and a  
 10 number of them had their entire life savings vanish from  
 11 the fraud. And often times, when there are Ponzi schemes  
 12 or Internet frauds or whatever, there is usually either  
 13 not jurisdiction to get the money back, or there is no  
 14 money to get back. So those are of particularly severe  
 15 consequence.  
 16 So we will continue to, you know, look and  
 17 regulate the local markets, retail investors, and also  
 18 work as states, multi-jurisdictionally, to look at cases  
 19 that have a greater impact. We're working on  
 20 multi-jurisdictional, you know, plans to make it more  
 21 efficient for us to bring cases as multiple state  
 22 jurisdictions. And that's not an easy task, because  
 23 states want to have their sovereignty, as well as help  
 24 with each other. But you know, the states are working  
 25 more cooperatively on cases that have a larger market

1 consequence, but are also there on the retail side to  
 2 protect the retail investor.  
 3 So, with that, I think that's the highlights of  
 4 the report, and happy to answer any other questions.  
 5 CO-CHAIR GRAHAM: Well, Mike, maybe I'm  
 6 jet-lagged, and I just missed it, but one of the things  
 7 that we're always wrestling with is balance, and balance  
 8 between doing what we can to make capital formation  
 9 easier, and then, of course, investor protection.  
 10 And I just -- I was just wondering about your  
 11 take on the connection between level of regulation and  
 12 fraud, and actual fraud prevention.  
 13 MR. PIECIAK: Yeah, and I think that's a good  
 14 point, because, I mean, the two -- on the corporation  
 15 finance side, when you're talking about regulation, I  
 16 think you have to categorize them into trying to prevent  
 17 outright fraud, which is kind of hard to do. I mean,  
 18 regardless of what regime you have in place, or what the  
 19 regulations are, you know, there -- what's the -- the old  
 20 saying is that the bank robber doesn't wait in line at  
 21 the teller's, you know, the teller line, or whatever.  
 22 And I think that's probably consistent with securities  
 23 fraud, that those that are going to commit outright  
 24 fraud, it's hard to police them, other than to provide  
 25 investor education, to ourselves be very vigilant for

1 things like free dinner, you know, planning events and  
 2 free lunch planning events, and to keep our ear to the  
 3 ground as to events that are happening in our own states.  
 4 And then there is the other category of risk and what's  
 5 the appropriate level of risk for investors, and that's a  
 6 totally different conversation.  
 7 So I think, in terms of the outright fraud, I  
 8 mean, it's hard to -- again, it's hard to regulate that  
 9 in terms of preventing it. I think it's a multi-pronged  
 10 approach. Education, state regulators have an active  
 11 enforcement program. Investors, knowing who to turn to  
 12 when they have a complaint. And then, in terms of  
 13 striking the right balance of the other part of the  
 14 equation, of the risk equation, you know, I think  
 15 where -- I think both the SEC and states have been  
 16 working diligently on trying to strike that right  
 17 balance.  
 18 We have created programs in Vermont to help  
 19 small businesses raise money. That doesn't mean that  
 20 we're going to let the programs go and run without any  
 21 oversight. We're going to continue to look, year over  
 22 year, whether the individual businesses are raising  
 23 money, whether they're doing the things that they said  
 24 they were going to do, whether there are investor  
 25 complaints.

1 So I think the states have tried to be  
2 innovative, and so has the SEC. And with that  
3 innovation, you know, that is great, but it's more of an  
4 ensuring that you sort of monitor what happens as a  
5 result of that innovation, both on the good and the bad,  
6 and take appropriate steps, one way or the other.

7 But I think we've continued to try to strive  
8 that right balance with investor protection and capital  
9 formation. I think the SEC has worked diligently to try  
10 to do that, and has been -- through compromise, has been  
11 striving toward that right balance point.

12 CO-CHAIR GRAHAM: You know, maybe you can  
13 just speak briefly to this. It seems to me that the  
14 right way to go is a significant focus on enforcement, as  
15 opposed to layering on regulations. I'm just wondering  
16 if -- I mean, in very simplistic terms, cut back all the  
17 regulations, say, "Look, don't commit fraud. If you do,  
18 then Mike is going to come after you," and then just --  
19 let the enforcement folks police the fraud. What is  
20 your --

21 MR. PIECIAK: Yeah, well, I guess the only --

22 CO-CHAIR GRAHAM: -- sense of how that's  
23 calibrated?

24 MR. PIECIAK: I guess the only posit I have on  
25 that is -- you know, and this is one thing we're

1 have to keep a close eye on and monitor.

2 But I do think that having certain regimes and  
3 certain avenues that are appropriate for investing makes  
4 it easier for investors to decipher whether something is  
5 legitimate or not. So I do think enforcement is an  
6 important component, but that's the only pause I have as  
7 to whether it's, you know, rolling back regulation  
8 completely and leaving it to the enforcement team to --

9 CO-CHAIR GRAHAM: But that was an  
10 over-simplification --

11 (Laughter.)

12 CO-CHAIR GRAHAM: I was just trying to make  
13 a point.

14 MR. PIECIAK: Yeah.

15 MR. YADLEY: Just to pick up on something that  
16 we talked about, and I was happy that you didn't  
17 mention -- of course I'm sensitive to seniors being  
18 preyed upon when we talked about the definition of  
19 accredited investors. There had been some discussion at  
20 some levels that maybe we needed to be a little more  
21 paternalistic about protecting seniors. I would  
22 certainly like to reiterate what was the sense of the  
23 group at the time, that that's an area where we'd  
24 probably be going too far on the investor protection line  
25 to include in regulations a prohibition against seniors,

1 monitoring at the state level across the country, and I'm  
2 sure the SEC is, as well -- but just for example, you  
3 know, 506(b) offerings and now 506(c) offerings, so in  
4 the past somebody might get an offering in the mail and  
5 say, you know, "This is a private placement," or  
6 whatever, not sold, or whatever, or not sold publicly.  
7 And the investor would think, you know, I know this is  
8 not something I can invest in, this is -- this must be a  
9 fraudulent offering, or it's not appropriate for me, or  
10 whatever.

11 And now, you know, with the 506 offerings,  
12 every so often we have a broker-dealer or investment  
13 advisor in Vermont will mail us something and say, you  
14 know, "Is this allowed? You know, this got mailed to my  
15 clients," or whatever. And so if you have no regulation,  
16 sometimes it's a little bit harder to determine what  
17 might be a legitimate versus illegitimate offering.

18 Same thing with crowdfunding. I mean, you  
19 know, 5, 10 years ago the opportunity to invest locally  
20 or invest in a crowdfunding offering didn't exist. Now  
21 it does. And for legitimate companies and legitimate  
22 offerings, it could be a really great way to raise money.  
23 But it also provides fraudsters an opportunity to mask  
24 their fraudulent offering in a somewhat, you know,  
25 legitimate, you know, clothing. So it's something we

1 by virtue of the fact that they're seniors, or are  
2 investing retirement funds in certain securities.

3 MR. PIECIAK: Yeah, and probably a  
4 prohibition -- I mean at our Department we regulate  
5 insurance, as well as securities. And, you know, I don't  
6 think any of our regulations we've ever sort of tried to  
7 have, you know, an outright ban, or whatever. But  
8 another example is, you know, annuity suitability. And  
9 sometimes, you know, you might have a suitability  
10 regulation that says if you sell an annuity to somebody  
11 over the age of 65, there has to be a heightened or a  
12 secondary review by somebody within the insurance  
13 company, or what not.

14 So we do look at age, and I think it's maybe at  
15 certain times appropriate to look at age or other  
16 characteristics of vulnerability, and ensure that what's  
17 being offered or what's being done is appropriate. But,  
18 yeah, I don't think -- an outright ban is not probably  
19 the way to go.

20 MR. REARDON: Would your numbers include  
21 churning and --

22 MR. PIECIAK: Yes. I think in the investment  
23 advisor or registered, you know, numbers that we showed  
24 in the respondents, churning did show up as, you know,  
25 one of the reasons why enforcement actions were brought

1 against either firms or individuals.

2 Churning, I think, was something that was  
3 probably more prevalent a decade ago. You know, we still  
4 see it now. There is also something that's new on the --  
5 you know, new to the party, which is reverse churning.  
6 And I have to remember exactly what it is, but it's  
7 basically moving -- it's moving somebody from a -- you  
8 know, an account that, you know -- yeah, and moving it  
9 into the account that has no commissions. But you don't  
10 anticipate doing any active trading in it anyway, so why  
11 did you move it to a managed account, and then -- you  
12 know, so it's kind of the opposite of what you would have  
13 churning 10 or more years ago.

14 MS. YAMANAKA: So, Michael, I have a  
15 clarification. When you said that this -- the year that  
16 you're discussing we had more registered offenses than  
17 unregistered -- so particularly within senior fraud or  
18 any kind of fraud in general, is that kind of an  
19 indicator that it's going down, which I'm not hearing you  
20 say that, but that registered people are entering into  
21 that field a little bit more?

22 (Laughter.)

23 MS. YAMANAKA: I mean --

24 MR. PIECIAK: Well, I'll mention two things.  
25 One thing was that the research -- or not the research.

1 The study showed that in the -- that seniors, when it was  
2 unregistered fraud, you know, there were -- the victims  
3 of unregistered fraud were -- I think it was, like, 2.5  
4 percent more likely, or 2.5 times more likely, I should  
5 say, to be elderly or otherwise vulnerable. So, you  
6 know, seniors made up a disproportionate number of  
7 victims in the unregistered arena.

8 So -- and then senior issues have been  
9 increasing. So I don't think it's necessarily that that  
10 behavior is getting better, you know, but -- and again,  
11 the numbers this year -- it was the first time that  
12 registered was over unregistered, but it was very close.  
13 It was something -- the number of cases were a few dozen  
14 apart, or something like that.

15 CO-CHAIR HANKS: Mike, I got a question  
16 about the federal-state split. A lot of the things that  
17 you're looking at both the state and the Feds have  
18 jurisdiction. Do you keep numbers on how many of these  
19 things get bounced by the states to the Feds, or the  
20 other way around?

21 MR. PIECIAK: Yeah, we do. And they're not in  
22 this report, and I don't know if we didn't ask for the  
23 information for this report, or they haven't -- or they  
24 just decided not to include them. But in the previous  
25 reports I looked at, you know, both referrals from the

1 state to the Feds -- and that Feds could be the FBI or  
2 the SEC or reverse -- you know, the -- I think the  
3 bandwidth was somewhere between -- both referrals to and  
4 from were between 500 and 1,000. So there were a number  
5 of cases that either came into us and we sent to the SEC,  
6 or vice versa.

7 And often times, you know, the FBI and -- at  
8 least in Vermont -- is probably look at a -- they're  
9 probably wanting a financial crime case that's in excess  
10 of \$1 million to, you know -- to be able to devote  
11 significant resources to it. So they might refer us a  
12 case that's less than that, or what not. So I think  
13 often times those sort of jurisdictional and resource  
14 issues come into play when the referrals are made.

15 MR. GOMEZ: Mike, a question following up on  
16 something that Catherine asked. And I realize you may be  
17 able to speak only with respect to Vermont and not all  
18 the states, but what do you consider 506 fraud? Are you  
19 looking for an indication that either the offering  
20 document referred to this -- are you only looking at  
21 those cases in which the company had actually -- or the  
22 issuer had actually filed a form D? How do you  
23 distinguish something that might be a 506(b) versus a  
24 4(a)2 or something where the fraudster was just doing  
25 fraud --

1 MR. PIECIAK: Yeah.

2 MR. GOMEZ: And then, when you bring the  
3 action, they default to 506 as being this safe harbor  
4 that they may try to make an argument for satisfying, as  
5 opposed to something else that would have required  
6 something that they just can't demonstrate was the  
7 case --

8 MR. PIECIAK: Yeah, yeah. That's a good  
9 question. I mean when I -- we think of -- at least I  
10 think of it in Vermont as being a situation where there  
11 is a private placement memorandum and they said, you  
12 know, we're in reliance of 506. It doesn't mean that  
13 they filed, you know, the Form D with the SEC. And we're  
14 not thinking necessarily of cases where there has been  
15 sort of a fraud without any documentation, and then, you  
16 know, it has a revisionist history move -- it's sort of,  
17 "This is a 506 offering."

18 So that's how I've always thought of the  
19 information. I think that's probably how most of the  
20 state regulators view it, as well. And probably, you  
21 know, when you're talking about unregistered firms or  
22 unregistered individuals, there is another segment that  
23 is just, you know, fraudulent offerings, and they have no  
24 fig leaf of a 506 or some other, you know, regulatory  
25 exemption. So I think that's a separate category.

1 CO-CHAIR GRAHAM: Okay. Any other  
 2 questions?  
 3 (No response.)  
 4 CO-CHAIR GRAHAM: Thank you, Mike.  
 5 MR. PIECIAK: Yeah, my pleasure.  
 6 CO-CHAIR GRAHAM: Let's turn to our draft  
 7 recommendations. The first one I want to pick up is the  
 8 one concerning finders. And we've talked many times  
 9 about the finders issue, urging the Commission to take  
 10 steps to clarify the current ambiguity in broker-dealer  
 11 regulation for intermediaries in private placements who  
 12 identify or find potential investors.  
 13 The prior iteration of this committee made a  
 14 recommendation on finders to the Commission in September  
 15 of 2015. At our February meeting we have reiterated the  
 16 importance of this issue to so many of us, and decided it  
 17 was worth reiterating the recommendation. With a new  
 18 chairman and new senior leadership coming in to the SEC,  
 19 we wanted to do what we could to keep this issue from  
 20 being overlooked.  
 21 I think everyone has a copy of the draft. I  
 22 think everyone has a copy of our first round of  
 23 comments, which came from Patrick. Does anyone -- is  
 24 anyone not so armed?  
 25 (No response.)

1 CO-CHAIR GRAHAM: Okay. Any additional  
 2 comments? I was going to ask you that, Patrick. Want to  
 3 take us through your comments?  
 4 MR. REARDON: Yeah. The private placement --  
 5 there are a lot of names that get kicked around here, so  
 6 I thought just the insertion of the term "private  
 7 placement broker" or "brokers" would be helpful.  
 8 Paragraph four down there points out that there  
 9 has been a little bit of action in the way of no-action  
 10 letters. But I think it's worthwhile to point out that  
 11 those are staff interpretations, rather than action of  
 12 the Commission. And they are limited in scope, and there  
 13 is no certainty -- less certainty that a court would be  
 14 persuaded by them, since they're not action of the agency  
 15 that's charged with administering the law.  
 16 And then the changes down in -- the  
 17 recommendation in the first sentence are really my  
 18 attempt to put a little more detail in there.  
 19 And then the most important change that I made  
 20 was that in the first sentence I said, "Enact rules," and  
 21 then I deleted the last sentence, which invited more  
 22 regulatory action. Again, the reason being that that's  
 23 not action by the Commission, and we've not had  
 24 tremendous success with getting a lot of interpretive  
 25 action.

1 So, those are my thoughts on why I made those  
 2 recommendations.  
 3 CO-CHAIR GRAHAM: Okay. Well, frankly, it  
 4 makes sense to me. As I recall, this is not inconsistent  
 5 with the recommendation that we made a year or so ago.  
 6 MR. YADLEY: Yeah, that's correct. And  
 7 notwithstanding that guidance would be useful, I think  
 8 Pat makes a good point. And I'm -- I think enact rules  
 9 rather than take action is a good suggestion.  
 10 CO-CHAIR GRAHAM: And does -- would it make  
 11 sense to make specific reference to the prior  
 12 recommendation, and expressly state that we are  
 13 reiterating that recommendation, as opposed to in lieu  
 14 of?  
 15 CO-CHAIR HANKS: It would if we're going to  
 16 come out on the rule side. But could I just argue in  
 17 favor of anything, any kind of certainty whatsoever,  
 18 whether it's CDIs, whether it's FAQs, whether it's  
 19 no-action letters, just something after 17 years?  
 20 Because we -- I could see a rule-making which has to go  
 21 through a very balanced process, you know, and it -- you  
 22 know, you're talking about several months out there for  
 23 any kind of rule-making process, where you're going to  
 24 get a lot of arguing about what policy positions should  
 25 be.

1 I mean we're not talking about anything in the  
 2 next 18 months, except in some ideal world that we don't  
 3 live in.  
 4 CO-CHAIR GRAHAM: Yeah, it seemed like --  
 5 as I recall, one of the things that was said before is  
 6 that we wanted to see the Commission do just what you  
 7 said, do something, and not necessarily wait until the  
 8 perfect rule was in place. And I think that that  
 9 sentiment should be reflected in this, as well.  
 10 MR. GOMEZ: Steve, just to -- sorry, just to  
 11 answer specifically your question, the previous  
 12 recommendation from this committee was broader in the  
 13 sense of detail. So one thing to your question to  
 14 consider is if you are limiting what the recommendation  
 15 is here to just enactment of rules, but then at the same  
 16 time you're also re-adopting the previous recommendation,  
 17 are you limiting to just enacting rules, or are you also  
 18 recommending everything else that was recommended in that  
 19 other recommendation, some of which might have been done  
 20 without doing rules, in the sense that -- are you  
 21 re-adopting a recommendation that was broader than how  
 22 Patrick narrowed it here? And, if so, which one is it?  
 23 So just something for you guys to consider. I  
 24 mean, at the end of the day, it's your recommendation.  
 25 PARTICIPANT: And that's sort of the -- and I

1 actually had written down "enact rules or provide  
 2 guidance." But --  
 3 CO-CHAIR HANKS: You could say  
 4 "preferably."  
 5 PARTICIPANT: Yeah. Sebastian is right. And  
 6 we've actually made recommendations on two different  
 7 occasions, and we hearkened back to the task force and  
 8 the recommendations of the forum on small business  
 9 capital formation, many of which were very specific, in  
 10 terms -- included things such as amounts and types of  
 11 transactions.  
 12 We're trying to be forceful. And I'm -- take  
 13 action was great. You convinced me. I could easily sway  
 14 the other way. The point is we do want to do something.  
 15 It says in the near future, and I'm not aware that the  
 16 Commission is ever -- although "ever" is a strong term --  
 17 just come out of nowhere and said something. There's  
 18 been thoughtful staff discussion, there's been proposals,  
 19 or there has been an imperative from Capitol Hill. But I  
 20 think the force of our recommendation is more important  
 21 than whether we compromise on -- rather have guidance if  
 22 you'll do it right now, but rules would be better because  
 23 it would be more comprehensive. And trust the staff and  
 24 the new full Commission to say, okay, we agree it's  
 25 important, and have more dialogue.

1 But I think everybody's views on this one are  
 2 important, because it is such a key issue.  
 3 CO-CHAIR GRAHAM: Yeah. I take your point.  
 4 And I think that makes sense. We certainly don't want  
 5 interim guidance to be a substitute for rules that  
 6 essentially fix the issue.  
 7 CO-CHAIR HANKS: And if I could interject,  
 8 also not a concept release, which is sort of like a -- we  
 9 see that happen. Sorry.  
 10 (Laughter.)  
 11 CO-CHAIR HANKS: Nothing interim, nothing  
 12 concept. Actual guidance.  
 13 CO-CHAIR GRAHAM: Okay.  
 14 PARTICIPANT: How would we wordsmith that so  
 15 that we --  
 16 CO-CHAIR HANKS: "Please do not issue a  
 17 concept release."  
 18 (Laughter.)  
 19 CO-CHAIR HANKS: I mean in plain English.  
 20 PARTICIPANT: I don't know. Okay.  
 21 CO-CHAIR GRAHAM: You could say, "enact  
 22 rules or provide definitive guidance in the near future,"  
 23 but it does say provide regulatory certainty.  
 24 CO-CHAIR HANKS: I mean that's what we're  
 25 aiming for, is that certainty issue.

1 CO-CHAIR GRAHAM: So I think, as long as  
 2 we're recommending -- if we enact -- in the near term  
 3 we're recommending that we enact rules and that we  
 4 provide guidance, all in the effort to address this  
 5 uncertainty, that's said what we wanted to say, haven't  
 6 we?  
 7 MS. YAMANAKA: Can I ask a question about this?  
 8 Because I didn't have any orientation to this until I  
 9 came to the meeting. And clearly, it's been ongoing.  
 10 What struck me and what pushed me over the edge was the  
 11 17 years. Right? I mean 17 years? Marriages last less  
 12 than that time. So -- not mine, though.  
 13 But I think that's -- when you read this, it  
 14 sounds like, okay -- it just doesn't sound as strong as  
 15 when you're going there's been no movement on this for 17  
 16 years. So I'm kind of with Sara in the sense that if you  
 17 don't want to do it, then you have to make a stand and  
 18 say, "We're not going to do it," as opposed to making the  
 19 request and making it sound polite. And again, if I just  
 20 read it as is, it just sounds kind of -- a little bit  
 21 testy, but not over the edge. But, I mean, 17 years?  
 22 What does it take?  
 23 So I just put that out for the group because --  
 24 you know, and I know we're in a different administration,  
 25 so maybe that makes a difference. But the past 17 years

1 we've covered a lot on both sides. So I'd just like to  
 2 know why. Why isn't there a position taken? Or to just  
 3 come back and say, "We aren't going to do this," and then  
 4 we can decide what we want to do.  
 5 CO-CHAIR GRAHAM: Well, it seems to me  
 6 that -- I mean I don't know how much -- I mean I think  
 7 that we're sufficiently direct by stating that, look,  
 8 nothing has been done for a while, we want you to take  
 9 action. I don't think that that's impolite. And I don't  
 10 think it's being overly polite.  
 11 MS. YAMANAKA: I defer to the group. It's just  
 12 that, to me, the 17 years was instrumental in my pushing  
 13 forward to staff. That's all.  
 14 CO-CHAIR GRAHAM: Okay. Annemarie?  
 15 MS. TIERNEY: I wouldn't mind seeing that in  
 16 here.  
 17 CO-CHAIR GRAHAM: Seventeen years?  
 18 MS. TIERNEY: Yeah.  
 19 CO-CHAIR HANKS: Is it not?  
 20 MS. TIERNEY: It's not here.  
 21 CO-CHAIR HANKS: Well, repeated --  
 22 longstanding, 17 years?  
 23 MS. TIERNEY: Whatever it is. Whatever it is.  
 24 I mean that's a pretty -- we all know this is an issue in  
 25 the space. We in the state see this as an issue. We

1 know it's an issue.  
 2 CO-CHAIR GRAHAM: Is it -- Julie and  
 3 Sebastian, do you know whether that number is correct?  
 4 MR. GOMEZ: Yeah, it is, 2005 was the ABA task  
 5 force report. Also, there was a small business advisory  
 6 committee that, in their final recommendations of  
 7 April -- it was either 2007 or 2008, but I can't remember  
 8 which -- urged the Commission to adopt the principles in  
 9 the 2005 ABA task force --  
 10 MS. DAVIS: So -- and forgive me because I'm  
 11 not as familiar with the history on this one -- but is  
 12 it -- 2005 is the earliest that --  
 13 MR. GOMEZ: No, no, that was --  
 14 MS. DAVIS: I know it's been raised for a long  
 15 time. But maybe you want to cite a document that has a  
 16 year.  
 17 MR. GOMEZ: Well, the 2005 ABA report. The  
 18 2006 SEC advisory committee and small business forms  
 19 for -- we can go back as long as we want.  
 20 MR. REARDON: Since dinosaurs roamed the earth.  
 21 CO-CHAIR GRAHAM: So you -- the earliest  
 22 data I heard is 2005.  
 23 MS. DAVIS: So the ABA task force caught it by  
 24 saying it had been a problem before, right? So you're --  
 25 MR. REARDON: In the last century.

1 (Laughter.)  
 2 MS. DAVIS: So I would like to see that kind of  
 3 background, because I think that adds fuel to why the  
 4 tone of this is action-oriented. It's a problem in the  
 5 market. And I like the paragraph that, you know, we're  
 6 disappointed. I was disappointed in Steve Luparello's  
 7 testimony to us on the topic. He seemed like he just  
 8 kind of shrugged it off and said, "Well, we do  
 9 enforcement where we do enforcement," and that felt very  
 10 unsatisfactory.  
 11 So I think something strong from the committee  
 12 is warranted, based on the history, the length of time,  
 13 and kind of trading in markets idea that, you know, well,  
 14 we do take enforcement every now and then. I wouldn't  
 15 mind seeing us say something like we want the Commission  
 16 to, you know, enact rules and, in the meantime, while  
 17 those rules are pending, you know, issue guidance that  
 18 provides certainty in the short term over the long-term  
 19 rule-making process, if we can ask them to do that.  
 20 CO-CHAIR GRAHAM: I think all those are  
 21 good ideas. Essentially, we're, you know, tying back to  
 22 the 2005 document. And so -- with respect to we want to  
 23 see some rules. But in the meantime, let's do what we  
 24 can to --  
 25 MS. TIERNEY: And I don't know what the last

1 recommendation was, Stephen. So I don't know -- when  
 2 you're saying it was more specific, Sebastian, like, were  
 3 there actual things that we said the rules should  
 4 include?  
 5 MS. DAVIS: Yeah, it's pretty long. I can read  
 6 it to you, if you want, or -- I mean, well, first of all,  
 7 in the 15, 12 -- in the number of years it cites the ABA  
 8 task force in 2005, and as recognized by this advisory  
 9 committee and the small business forum since 2006, and it  
 10 documents the things that were documented in those  
 11 reports. So you could cite to that, if you wanted, on  
 12 the timing.  
 13 And then there were four recommendations. The  
 14 Commission takes steps to clarify the current ambiguity  
 15 in broker-dealer regulation by determining that persons  
 16 that received transaction-based compensation solely for  
 17 providing names of or introductions to prospective  
 18 investors are not subject to registration as a broker  
 19 under the Exchange Act. And there's three others. I  
 20 will only read them if folks want to hear them.  
 21 CO-CHAIR GRAHAM: All consistent with what  
 22 is currently on the table.  
 23 MS. DAVIS: Certainly not inconsistent. I mean  
 24 it does say -- the last one says, "The Commission should  
 25 take immediate intermediary steps to begin to address

1 issues regarding the regulation of intermediaries in  
 2 small business capital formation transactions  
 3 incrementally, instead of waiting until development of a  
 4 comprehensive solution."  
 5 CO-CHAIR GRAHAM: Right. When was that?  
 6 MS. DAVIS: That was 2015. So --  
 7 CO-CHAIR GRAHAM: 2015. And there was one  
 8 before that?  
 9 MR. GOMEZ: Yes, there was, the one before that  
 10 was not as --  
 11 MS. DAVIS: 2006.  
 12 MR. GOMEZ: -- as detailed as this one.  
 13 PARTICIPANT: This committee. I think we were  
 14 more polite the first time, and urging that the  
 15 Commission lead the effort, along with NASAA and FINRA.  
 16 Yeah.  
 17 MR. REARDON: We could just repeat that.  
 18 CO-CHAIR HANKS: Well, we're referencing  
 19 it, right, in the --  
 20 MR. YADLEY: So part of the question, I think,  
 21 is -- there is a lot out there. And I think I wrote a  
 22 paper for this committee in July a year ago. So the  
 23 question is do we want to be succinct and say, "Hey,  
 24 look, it's been X years. You should enact rules and  
 25 provide whatever guidance in the short term without



1 waiting for promulgation of the rules to do that," and  
2 leave it at that, or do we want to get chief consensus on  
3 things, some of which we already did, and be more  
4 detailed?

5 CO-CHAIR GRAHAM: It seems to me that if we  
6 follow the path described by -- suggested by Annemarie  
7 and cross-reference the prior recommendation, that should  
8 do it.

9 MR. REARDON: May I say -- offer something,  
10 which would be a -- put at the end of that last  
11 consideration paragraph, whether it's four or five?

12 Just, for example, "please see the attached,"  
13 and then you could put whatever you want to on there, as  
14 far as listing studies, the prior recommendations, and  
15 have three or four things on there, five, that --

16 CO-CHAIR GRAHAM: It seems to me that if we  
17 cross-reference the prior recommendation, and in the  
18 current recommendation, if we make reference to the 2005  
19 document, and we say that we want rule-making action  
20 taken, it may delay more or less. Certainly near term.

21 Meanwhile, if we want guidance to enhance  
22 the -- or to address the uncertainty in the area, that  
23 that should be -- that should do the trick.

24 MS. DAVIS: And underline "now" three times.  
25 (Laughter.)

1 CO-CHAIR GRAHAM: All caps?

2 MS. DAVIS: All caps, larger font.  
3 (Laughter.)

4 PARTICIPANT: So in number -- what's  
5 currently -- yeah, what's number three, we would -- right  
6 now it says "for years many interested parties." Would  
7 you want to change that to "for years, including a 2005  
8 ABA report," and that gets that 2005 in there, and  
9 then -- we've already got the "as one recent example in  
10 2015 this committee recommended." That "recommended" is  
11 a hyperlink that you can't see on paper, but -- or do you  
12 want something more specific as a cross-reference?

13 CO-CHAIR GRAHAM: That strikes me as  
14 sufficient.

15 CO-CHAIR HANKS: Or you could say, "the ABA  
16 report and earlier." That's throwing in the ABA --

17 CO-CHAIR GRAHAM: Okay. All right. We all  
18 kind of have a sense for what the --

19 MS. YAMANAKA: So is Patrick's number four  
20 staying, or no?

21 CO-CHAIR GRAHAM: I don't think we need it,  
22 because it's going to be in the hyperlink, right? We'd  
23 just be picking up the language for the prior -- was that  
24 the suggestion?

25 MR. REARDON: Yeah --

1 PARTICIPANT: Well, I think at the end of the  
2 last one you could say, "long-standing requests,  
3 including," and then, "as set forth in committee's prior  
4 recommendations." And if the prior recommendation -- I  
5 think it does reference the ABA report -- I hate drafting  
6 by committee, so --

7 (Laughter.)

8 CO-CHAIR GRAHAM: I know, I know. So as  
9 long as we get the concepts down, then we can stop trying  
10 to draft by committee.

11 But your question, though, was whether the  
12 language about kind of intermediate steps, whether we --

13 MS. DAVIS: Yeah.

14 CO-CHAIR GRAHAM: But that would be taking  
15 the language from the prior recommendation and dropping  
16 it into this recommendation. Is that -- am I  
17 understanding that?

18 MS. DAVIS: Well, my -- the first question was  
19 Patrick had added this, after considering that,  
20 another -- whole other number, "What action has been  
21 taken has been limited to staff interpretation such as  
22 no-action letters" --

23 CO-CHAIR GRAHAM: Oh, I think that's fine.

24 MS. DAVIS: Okay. So that stays?

25 CO-CHAIR GRAHAM: Yeah, that's fine.

1 MS. DAVIS: Okay.

2 CO-CHAIR GRAHAM: Okay. Are we good on  
3 that?

4 MS. DAVIS: Sorry, one more clarification. So  
5 you want to say the Commission enact rules in the near  
6 future?

7 CO-CHAIR HANKS: Can we say "adopt," as  
8 opposed to "enact," just --

9 CO-CHAIR GRAHAM: Yes.

10 MS. DAVIS: To provide regulatory certainty?  
11 And so no reference to, and in the meantime guidance, or  
12 you do want that?

13 CO-CHAIR GRAHAM: Yeah, we do want that.  
14 Yeah.

15 MS. DAVIS: You do want that.

16 CO-CHAIR GRAHAM: Yeah.

17 MS. DAVIS: Okay.

18 MS. TIERNEY: Adopt rules and, pending adoption  
19 of those rules, provide guidance that creates clarity and  
20 certainty.

21 CO-CHAIR HANKS: And then we might want to  
22 change the -- move the definition of the Securities Act  
23 up to the first time it's cited, and that kind of thing.

24 CO-CHAIR GRAHAM: What I would suggest is  
25 that, once there is some consensus, and we appear to

1 be -- to have achieved consensus, that we draft something  
 2 and then re-circulate it to the group. Make sense?  
 3 MS. TIERNEY: Can we ask for -- so which --  
 4 would this be directed to the division of training and  
 5 markets?  
 6 MS. DAVIS: All the recommendations have  
 7 historically been directed to the chairman of the  
 8 Commission.  
 9 MS. TIERNEY: No, but the call for action.  
 10 Would that be -- that would be rule-making? That would  
 11 be --  
 12 MS. DAVIS: This would definitely be something  
 13 done out of trading and markets, if it's rule-making,  
 14 and -- or guidance.  
 15 MS. TIERNEY: Can we ask for a report back on  
 16 the status? Maybe, like, the next six months or --  
 17 MS. DAVIS: Well, keep in mind that your term  
 18 ends in September of the Committee. So there is one more  
 19 meeting, unless we do a telephone meeting, which is  
 20 certainly doable.  
 21 MR. REARDON: We'll be out of her hair soon.  
 22 (Laughter.)  
 23 MS. DAVIS: Yeah, but there will be new ones of  
 24 you. Just kidding. So you know, just keep that in mind,  
 25 in terms of it's going to be different people. I mean

1 that's way above my pay grade, but --  
 2 CO-CHAIR GRAHAM: I think we can always ask  
 3 for that, it seems to me.  
 4 MR. REARDON: This is not serious, but if you  
 5 want a moment of levity, we could always put up here in  
 6 the title, 3.b.3.0.  
 7 (Laughter.)  
 8 CO-CHAIR GRAHAM: Okay. Do we feel that  
 9 we're in a position to pass this recommendation today, or  
 10 do you want to see it -- do you want to see a redraft?  
 11 PARTICIPANT: I trust the chairs to put our  
 12 thoughts in writing, so that we avoid delay.  
 13 CO-CHAIR GRAHAM: Okay. In that case,  
 14 could I have a motion that we adopt the recommendation,  
 15 as amended?  
 16 MR. YADLEY: So moved.  
 17 MS. MOTT: Second.  
 18 CO-CHAIR GRAHAM: Okay.  
 19 All those in favor?  
 20 (Chorus of ayes.)  
 21 All those opposed?  
 22 So now it's on to our recommendation on  
 23 secondary market liquidity. And during the February  
 24 meeting we also discussed the problem of limited  
 25 liquidity in secondary markets for holders of shares in

1 smaller companies. We focused in particular on companies  
 2 that are providing semi-annual reports, following a  
 3 regulation A, T, or 2 offering.  
 4 Availability of these ongoing updates means  
 5 there is information available to help establish pricing  
 6 and transparency in the secondary market. Yet investors  
 7 in Reg A securities are likely to have a difficult time  
 8 when they are ready to sell their shares, with one key  
 9 reason being that they have to find state exemptions for  
 10 each trade.  
 11 We discussed that this is an area where it  
 12 makes sense for the Commission to consider using its  
 13 Section 18 preemption authority. Nothing that the  
 14 majority of states already have exemptions for these  
 15 secondary trades, we agreed that the Commission should  
 16 collaborate with NASAA in this area. Again, I think you  
 17 all have a copy. Once again, Patrick provided comments.  
 18 And I would ask that Patrick walk us through his comments  
 19 to get started.  
 20 MR. REARDON: One, in paragraph two, the  
 21 sentence added at the end. It may not be the greatest  
 22 literary sentence ever written, but the thought is that  
 23 illiquidity has a discount on value. And we did discuss  
 24 that, because I remember mentioning it. I think that's  
 25 worth noting.

1 CO-CHAIR GRAHAM: I'm sorry, what did --  
 2 what's --  
 3 MR. REARDON: The sentence added at the end of  
 4 paragraph two. Also, the securities lacking in available  
 5 market generally bear an illiquidity discount on value.  
 6 CO-CHAIR GRAHAM: Okay.  
 7 MR. REARDON: The third paragraph that I added  
 8 is the result of my reading this entire recommendation,  
 9 and saying we want there to be some sort of exchange  
 10 here, but never really saying how it would operate. And  
 11 my thought was -- and I don't know how to operate it. So  
 12 I went looking for something that -- somebody said a  
 13 little bit something about how to operate it. And I  
 14 found this from a speech that Dan Gallagher gave in 2014  
 15 that has a little bit about it, so I thought it really, I  
 16 hope, strengthens the recommendation, because it  
 17 indicates we at least have given some thought to how such  
 18 an exchange might operate. He is using the term  
 19 "venture exchanges," which I'm willing -- happy to adopt.  
 20 But it's really only intended to make the recommendation  
 21 appear well thought out.  
 22 And then the last bullet on number four on page  
 23 three is from Michael. I think that's important for them  
 24 to know, that we're not trying to stifle state  
 25 regulators' anti-fraud jurisdiction. And if there is

1 fraud in connection with all of this, that -- this  
2 trading -- that certainly nothing here is intended to  
3 step in the way of their going after the miscreants.

4 And I couldn't figure out what alternative  
5 number three was for, so I would delete it. But I do  
6 think, if you put it in, that the legal requirement is to  
7 provide material information, rather than the information  
8 necessary for parties to make an educated investment  
9 decision.

10 CO-CHAIR GRAHAM: Okay. A couple of -- one  
11 question. You took some of the language in the -- in  
12 paragraph three, the recommendation, and dropped it into  
13 a footnote.

14 MR. REARDON: Oh, I'm sorry, excuse me. I  
15 thought that that last sentence in that paragraph, which  
16 was paragraph -- yes, paragraph three, was an explanatory  
17 note, rather than, really, a recommendation. So I just  
18 slid it down into a footnote.

19 CO-CHAIR GRAHAM: Okay.

20 MR. REARDON: And there is no pride of  
21 authorship. I mean if you disagree with that, I'm -- you  
22 know --

23 CO-CHAIR GRAHAM: I don't think it matters,  
24 so it doesn't really matter to me.

25 I hesitate to bring venture exchanges into the

1 discussion for this recommendation. I think we've done a  
2 venture exchange recommendation. I think that this -- I  
3 mean that conjures up, you know, a lot of things. And,  
4 as you have indicated, it is coming up with alternative  
5 markets, special markets for the trading of smaller  
6 company shares. And that can take so many different  
7 forms, and there is so much debate on that subject that  
8 I'm not sure if it should be included in a recommendation  
9 which, essentially, is to bring back the manual  
10 exemption. So I would be disinclined to include that for  
11 that reason.

12 CO-CHAIR HANKS: I would agree with that.  
13 I think this -- it dilutes the impact of this  
14 recommendation, which is we need secondary trading.  
15 Where that secondary trading takes place is not part of  
16 this recommendation. In fact, you know, we have got a  
17 secondary trading forum in the OTC markets now that this  
18 would improve. And the other private markets, right?

19 Annemarie?

20 MS. TIERNEY: It gives other markets the  
21 ability to create alternative ways for trading to occur.  
22 And I agree, I wouldn't want to somehow seem to limit  
23 that to venture exchange. That doesn't exist, right? So  
24 there are plenty of existing platforms who are in the  
25 primary space that might be willing to get into the

1 secondary space if they were able to have a workaround  
2 from the manual exception problem.

3 MR. REARDON: I withdraw the recommendation.  
4 It sounds like you know more about it than I do, so --

5 CO-CHAIR GRAHAM: Okay, fair enough.

6 MR. REARDON: Take that out.

7 CO-CHAIR GRAHAM: Okay.

8 MS. TIERNEY: But I agree with Patrick, I'd  
9 like to see alternative three dropped.

10 CO-CHAIR GRAHAM: Yes. I agree with that.  
11 Any other comments?

12 MS. TIERNEY: I would also think I would like  
13 to see the recommendation be a bit stronger in the point  
14 three that's not the alternative to say the Commission  
15 should use its authority, as opposed to consider using  
16 its authority. That feels a little passive to me. It's  
17 in the committee recommendation section, number three.

18 CO-CHAIR GRAHAM: Right. Patrick exchanges  
19 "the Commission use its authority."

20 MS. TIERNEY: Oh, I'm sorry, I'm not looking at  
21 Patrick's, I'm sorry. I'm looking at the other one.

22 CO-CHAIR GRAHAM: Yeah, yeah.

23 MS. TIERNEY: Yeah, I agree with that.

24 CO-CHAIR GRAHAM: Okay. Other comments?  
25 (No response.)

1 CO-CHAIR GRAHAM: So, with those changes,  
2 can I have a motion to adopt?

3 MS. TIERNEY: So moved.

4 MS. MOTT: Second.

5 CO-CHAIR GRAHAM: All those in favor?  
6 (Chorus of ayes.)

7 CO-CHAIR GRAHAM: Opposed?  
8 (No response.)

9 CO-CHAIR GRAHAM: Okay. Well, that does it  
10 for what was on the agenda. We have a couple more  
11 minutes.

12 I guess our next meeting is scheduled for  
13 September. So class is out. Have a nice summer, See  
14 you September.

15 (Laughter.)

16 MR. YADLEY: Just to confirm, it's Wednesday,  
17 September 13th here, right?

18 CO-CHAIR GRAHAM: As I think Julie  
19 mentioned a moment ago, the September meeting is  
20 scheduled to be our last meeting, unless we have a  
21 telephonic meeting along the way. It may be difficult at  
22 this time, within the time allowed, to come up with some  
23 additional meaningful recommendations. And so one of the  
24 things that we're thinking about is that we should all  
25 put our heads together and think about the letter that we

1 should leave behind for the next iteration of this  
2 committee, and note the things that might come under the  
3 heading of unfinished business.

4 And so, if you could give some thought -- begin  
5 giving some thought to your ideas of some of the things  
6 that you would still like to see done, even if we aren't  
7 involved in trying to get them done, that would be  
8 helpful. We will figure out -- that will certainly be  
9 part of the discussion next time around, and hopefully  
10 we'll get a report put together before our official last  
11 day of existence, which I think occurs some time after  
12 the meeting.

13 Okay, yes?

14 MS. MOTT: Could we make sure we have on the  
15 agenda the final results of the pilot study, the tick  
16 pilot study?

17 MS. DAVIS: I don't think it will be the final  
18 results, because --

19 MS. MOTT: Okay. Oh, it'll be too early --

20 MS. DAVIS: -- they said it's a two-year pilot.

21 MS. MOTT: So August? Yeah, so it won't be  
22 ready, right? Yeah.

23 MS. DAVIS: I think that's right.

24 MS. MOTT: I was thinking it would be ready, it  
25 would be -- sorry. Silly girl.

1 PROOFREADER'S CERTIFICATE

2 In The Matter of: MEETING OF THE ADVISORY COMMITTEE ON  
3 SMALL AND EMERGING COMPANIES

4 File Number: OS-0510

5 Date: Wednesday, May 10, 2017

6 Location: Washington, D.C.  
7

8 This is to certify that I, Maria E. Paulsen,  
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10 attached proceedings before the U.S. Securities and  
11 Exchange Commission were held according to the record and  
12 that this is the original, complete, true and accurate  
13 transcript that has been compared to the reporting or  
14 recording accomplished at the hearing.

15 \_\_\_\_\_  
16 (Proofreader's Name) (Date)

1 (Laughter.)

2 CO-CHAIR GRAHAM: Okay. Anything else?

3 (No response.)

4 CO-CHAIR GRAHAM: All right. Safe travels.

5 (Whereupon, at 2:55 p.m., the meeting was  
6 adjourned.)

7 \* \* \* \* \*

1 REPORTER'S CERTIFICATE

2  
3  
4 I, Jon Hundley, reporter, hereby certify that the  
5 foregoing transcript of 171 pages is a complete, true and  
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8 MEETING OF THE ADVISORY COMMITTEE ON SMALL AND EMERGING  
9 COMPANIES.

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<b>A</b>				
<b>a.m</b> 1:16 107:6	111:14 122:1,2	114:11,20	154:8 161:7,18	10:9,14 112:25
<b>ABA</b> 154:4,9,17	122:8 142:8,9	122:24 136:12	163:14 165:19	115:22 169:10
154:23 156:7	142:11	151:12 156:3	169:2	170:15
159:8,15,16	<b>accounts</b> 24:5	<b>adage</b> 79:6	<b>adopted</b> 14:23	<b>agent</b> 43:5
160:5	29:7,14 51:3	<b>add</b> 127:15	121:15 122:13	<b>aggregate</b> 68:11
<b>ability</b> 8:25	76:16,19,23,25	<b>added</b> 160:19	122:14,16	71:15
10:22 43:21	78:23,24 79:1	164:21 165:3,7	<b>adoption</b> 161:18	<b>aggressive</b> 33:6
78:15 121:6	79:15,16	<b>addition</b> 103:13	<b>adult</b> 121:19	115:1
167:21	<b>accredited</b>	<b>additional</b> 44:15	<b>adults</b> 119:13	<b>aggressively</b>
<b>able</b> 17:18 18:6	140:19	46:12 62:25	<b>advance</b> 25:11	61:16
26:9 27:3,20	<b>accurate</b> 23:9	73:20 90:4	28:1 29:17	<b>ago</b> 71:14
30:11 31:18	172:12 173:6	94:8 102:15	<b>advantage</b>	139:19 142:3
34:18 37:18	<b>achieve</b> 12:9	104:20 123:25	117:21 130:23	142:13 148:5
46:2 64:14	<b>achieved</b> 162:1	125:6 147:1	<b>advantages</b> 34:9	157:22 169:19
70:21,21	<b>acquisitions</b>	169:23	<b>adversely</b> 106:7	<b>agree</b> 65:14 75:5
103:11 107:21	87:12	<b>Additionally</b>	<b>advertise</b> 81:6	80:8 85:22
108:10 114:4	<b>act</b> 26:9 62:2	114:3	<b>advice</b> 47:24	92:22 150:24
120:16 126:23	63:21 65:12	<b>address</b> 16:9	53:11 59:14	167:12,22
144:10,17	70:9 121:15,15	24:12 25:5	<b>advise</b> 41:8,11	168:8,10,23
168:1	121:16 125:17	43:6 54:24	46:19	<b>agreed</b> 81:23
<b>ably</b> 9:18	156:19 161:22	93:6 103:11	<b>advised</b> 45:14	164:15
<b>absence</b> 35:17	<b>action</b> 9:6	152:4 156:25	<b>advisor</b> 121:13	<b>agreeing</b> 108:11
<b>absolutely</b> 23:9	132:11,15	158:22	122:2 139:13	<b>ahead</b> 14:5
35:10 48:21	145:3 147:9,11	<b>addressed</b> 98:14	141:23	107:3 125:13
49:25 82:18	147:14,22,23	<b>addressing</b>	<b>advisors</b> 47:16	<b>aiming</b> 151:25
83:8 92:22	147:25 148:9	104:17	121:18 122:10	<b>alerts</b> 125:23
126:19 130:21	150:13 153:9	<b>adds</b> 155:3	<b>advisory</b> 1:9	<b>all-or-none</b>
<b>abuse</b> 118:18,21	158:19 160:20	<b>adequate</b> 34:21	10:1 154:5,18	29:25
120:20 121:21	162:9	39:22 80:6	156:8 172:2	<b>all-out</b> 64:1
122:12 124:23	<b>action-oriented</b>	<b>adequately</b> 56:9	173:8	<b>Allegiancy</b> 34:22
125:16 135:3	155:4	<b>adjacent</b> 32:19	<b>advocated</b> 18:1	36:19
<b>academic</b>	<b>actions</b> 110:25	<b>adjourned</b> 171:6	<b>affect</b> 76:3 78:15	<b>allowed</b> 20:17
103:14,18	111:10,11	<b>administering</b>	<b>affinity</b> 24:9	139:14 169:22
<b>accept</b> 91:20	112:2,3,4,8,11	147:15	26:16 117:16	<b>allowing</b> 20:22
<b>accepted</b> 96:10	113:20 115:4	<b>administration</b>	117:19,22	<b>allows</b> 94:11
<b>accepting</b> 62:20	115:12 116:17	5:17 152:24	118:1,5,9	121:25 125:24
<b>access</b> 10:15,23	124:25 127:17	<b>administrative</b>	134:7	<b>alluded</b> 26:14
12:1 17:24	127:25 129:14	112:25	<b>affirm</b> 172:9	<b>alternative</b>
18:4 80:19	130:13 141:25	<b>administrativ...</b>	<b>afford</b> 50:20	83:10 166:4
<b>accessible</b>	<b>active</b> 4:11 24:5	112:4	<b>afternoon</b> 4:20	167:4,21 168:9
110:22 124:24	58:10 137:10	<b>administrator</b>	5:2	168:14
<b>accessing</b> 12:19	142:10	5:18 112:23	<b>age</b> 48:17 84:20	<b>alternatives</b>
<b>accomplish</b> 16:1	<b>actively</b> 23:16	<b>Administrators</b>	118:17 121:2,3	89:13
<b>accomplished</b>	52:13	3:14	141:11,14,15	<b>amazing</b> 72:17
41:16 172:14	<b>activities</b> 67:16	<b>Adobe</b> 20:22,24	<b>agencies</b> 125:10	<b>ambiguity</b>
<b>accord</b> 92:13	98:13 120:1	<b>Adobe's</b> 20:11	126:3	146:10 156:14
<b>account</b> 26:5,24	<b>activity</b> 6:13	20:14	<b>agency</b> 9:12	<b>amenable</b>
26:25 55:8	<b>Acts</b> 132:10	<b>Adobi</b> 18:6	147:14	107:23
	<b>actual</b> 47:16	<b>adopt</b> 76:11	<b>agenda</b> 6:10 9:2	<b>amended</b> 1:18

163:15	79:12,13 82:2	137:10	<b>assisting</b> 9:18	86:6 91:11
<b>America's</b> 9:17	136:4 149:11	<b>appropriate</b>	<b>associate</b> 5:18	93:2 98:9,10
<b>American</b> 3:14	<b>answered</b> 79:24	10:5 11:4	6:18 13:12	98:22 103:5,19
<b>Ameritrades</b>	<b>answers</b> 106:13	15:13 16:20	<b>associated</b> 62:8	164:5 165:4
51:5	106:15,16,18	18:2 22:13	103:7,24	<b>avenues</b> 140:3
<b>Amgen</b> 21:5	106:19	23:3 24:16	105:20	<b>average</b> 28:9
<b>amount</b> 20:13	<b>anti-fraud</b>	26:8 29:13	<b>Association</b> 3:14	40:12 48:17
21:7 46:11	165:25	36:6 38:7	131:22	60:20 64:25
61:18 66:16	<b>anticipate</b>	55:23,24 80:9	<b>Associations</b>	68:15,17 95:21
75:12 113:9	142:10	80:11,14,17	131:11	99:20
133:17	<b>anybody</b> 73:1	81:8 137:5	<b>assume</b> 48:2	<b>averaged</b> 61:5
<b>amounts</b> 150:10	85:15,23 117:9	138:6 139:9	77:14 90:15	<b>averaging</b> 60:19
<b>Amy</b> 2:9 101:23	<b>anybody's</b>	140:3 141:15	<b>assured</b> 11:3	60:22
<b>analyses</b> 21:15	127:21	141:17	<b>ATs</b> 97:1 102:4	<b>avoid</b> 163:12
105:11,21	<b>anyway</b> 142:10	<b>appropriately</b>	<b>attached</b> 158:12	<b>aware</b> 18:11
<b>analysis</b> 3:12	<b>AOL</b> 21:4	18:23	172:10	62:19 103:14
62:12 101:5	<b>apart</b> 21:15	<b>approval</b> 45:23	<b>attack</b> 58:8	125:25 150:15
103:1,9,23	143:14	<b>approved</b> 95:14	<b>attempt</b> 32:5	<b>eyes</b> 163:20
105:10,25	<b>apologize</b> 53:5	98:16	93:20 147:18	169:6
129:5	<b>apparently</b>	<b>approximately</b>	<b>attempting</b>	
<b>analyst</b> 60:4,5	101:9	30:2	116:5	<b>B</b>
66:8,15	<b>appeal</b> 26:16	<b>April</b> 154:7	<b>attempts</b> 24:3	<b>B</b> 52:5 91:3
<b>analysts</b> 67:25	36:21 54:21	<b>area</b> 22:12 50:23	<b>attending</b> 14:11	<b>B's</b> 113:11
69:8 73:24	<b>appealing</b> 45:6	50:25 90:19	<b>attention</b> 50:15	<b>B-to-B</b> 36:20
<b>analyze</b> 110:13	56:6 63:2	140:23 158:22	124:8	<b>B-to-C</b> 36:22,25
124:20	<b>appear</b> 161:25	164:11,16	<b>attorney</b> 47:16	<b>back</b> 5:25 20:11
<b>analyzing</b> 9:14	165:21	<b>arena</b> 124:23	<b>attorneys</b> 120:5	31:24 41:21
125:3	<b>appearance</b>	130:14 143:7	134:25	51:11 54:24
<b>ancient</b> 20:11	26:10	<b>argue</b> 148:16	<b>attract</b> 50:14	58:4 60:9,15
<b>and/or</b> 117:13	<b>appearances</b> 5:7	<b>arguing</b> 148:24	94:7	60:16 61:6,23
<b>anecdotal</b>	<b>appears</b> 100:19	<b>argument</b> 145:4	<b>attractive</b> 61:17	62:11 67:3
108:21,23	101:18	<b>Arkansas</b> 13:11	63:6 65:12	72:9 74:22
125:19	<b>appetite</b> 52:9	59:19	68:20 85:2	82:16 84:4,18
<b>Anecdotally</b>	<b>applaud</b> 130:20	<b>armed</b> 146:24	<b>attractiveness</b>	87:14 88:13,24
130:14	<b>Apple</b> 18:6	<b>article</b> 63:8	88:6	107:14 111:17
<b>angel</b> 49:6 84:22	64:16 72:25	<b>articles</b> 15:17	<b>attributed</b> 82:9	113:5,9 114:11
<b>Annemarie</b> 2:19	<b>applicable</b> 15:25	<b>artist</b> 107:25	<b>audience</b> 75:23	114:12,15
91:24 153:14	<b>applied</b> 22:2	<b>asked</b> 14:14 16:8	<b>Audio</b> 94:23	117:11 122:9
158:6 167:19	116:1	68:17 82:17	<b>August</b> 98:22	123:7,21
<b>announced</b>	<b>applying</b> 28:21	86:24 110:20	103:5 170:21	133:16 135:13
92:11	<b>appreciate</b> 6:14	144:16	<b>author</b> 21:20	135:14 138:16
<b>annual</b> 108:16	7:8 8:20	<b>asking</b> 65:22	<b>authority</b>	140:7 150:7
131:23,23	<b>appreciated</b>	<b>aspect</b> 27:8 29:9	118:22 164:13	153:3 154:19
<b>annuity</b> 116:20	57:11	87:23	168:15,16,19	155:21 162:15
141:8,10	<b>appreciation</b>	<b>assessment</b>	<b>authorship</b>	167:9
<b>anomaly</b> 115:8	14:17	105:14,16	166:21	<b>background</b>
<b>answer</b> 16:8	<b>appreciative</b>	<b>asset</b> 78:25	<b>availability</b>	16:17 22:11
37:22 39:3,22	14:3	84:25 85:7	103:4 164:4	123:4 155:3
42:13 70:15	<b>approach</b>	<b>assisted</b> 28:21	<b>available</b> 61:18	<b>backlog</b> 63:17

<b>bad</b> 129:10 133:3 138:5	91:9	67:20	<b>blocks</b> 99:20	17:16 18:25
<b>Baird</b> 64:23	<b>BeautyKind</b>	<b>big</b> 56:17 61:11	<b>board</b> 54:22	21:12 22:9,16
<b>balance</b> 11:7 12:9 109:11,23 136:7,7 137:13 137:17 138:8 138:11	36:23 37:2,19 40:1,5,12,14 41:12	61:24 65:13 69:22 72:23 74:3 76:15 81:17 101:8 104:10	95:8	26:18 32:13
<b>balanced</b> 148:21	<b>beckoning</b> 94:20	<b>big-dollar</b> 132:7	<b>bolster</b> 54:20	48:6 50:22
<b>balked</b> 54:13	<b>becoming</b> 43:18	<b>biggest</b> 61:10	<b>bolstered</b> 126:17	53:9 58:17
<b>ball</b> 83:7	<b>began</b> 13:25	64:6 65:7	<b>book</b> 71:15,18	74:22 135:21
<b>ban</b> 141:7,18	59:17 100:6,7	<b>Bill</b> 6:2 14:12	72:20 93:11	145:2 166:25
<b>bandwidth</b>	<b>beginning</b> 58:5	15:14 17:25	128:6	167:9
144:3	94:7 98:6	18:11 22:1	<b>book-entry</b>	<b>bringing</b> 10:3
<b>bank</b> 13:20 87:5	106:2	<b>billion</b> 20:19,20	43:14	16:23 27:18
89:19 90:1	<b>begs</b> 51:12	23:12 84:21,22	<b>book-runner</b>	52:16 88:23
136:20	<b>behavior</b> 104:18	95:20 113:10	71:8	<b>broad</b> 16:21
<b>banker</b> 66:21	104:21 143:10	113:11,12	<b>boom</b> 81:22	17:14 18:23
76:5	<b>believe</b> 16:2 17:7	<b>billion-dollar</b>	<b>boots</b> 126:23	24:4,17 26:17
<b>bankers</b> 67:3	19:24 21:9,11	12:23	<b>bottom</b> 26:12	28:14 32:14,15
<b>banking</b> 13:9,14	21:24 23:2,7	<b>binary</b> 34:6	61:2 67:24	32:21 33:19
60:5 67:15	23:11,13 25:2	89:16	106:4	37:5 45:5
69:18	25:20 31:21,24	<b>biotech</b> 29:20	<b>bounced</b> 143:19	51:10 56:6
<b>banks</b> 63:24	31:25 34:25	<b>biotechnology</b>	<b>box</b> 49:20	80:18 94:2
69:22 76:3	35:24 36:6	90:3	<b>boxes</b> 43:12	117:20
87:2	48:7 50:21	<b>bit</b> 16:10,17,19	<b>Boy</b> 50:18 94:11	<b>broader</b> 74:16
<b>bar</b> 33:6 131:1	83:10 103:16	17:19 18:16	<b>bracket</b> 72:14	88:13 94:11
131:11,16,17	<b>believer</b> 17:25	19:17 20:2,9	72:15	149:12,21
131:22	<b>beneficial</b> 24:16	23:4,17 25:9	<b>Brad</b> 13:8,11,17	<b>broadest</b> 93:15
<b>Barclays</b> 14:1	<b>benefit</b> 10:6	41:23 50:17	13:18 14:6	<b>broadly</b> 36:21
<b>barred</b> 116:10	19:24 85:25	53:25 54:13,16	53:1,5 57:19	<b>broker</b> 35:1
<b>base</b> 65:20 78:5	105:6 109:4	55:1 56:25	57:21 70:16	37:12 147:7
78:15	<b>benefits</b> 11:1	57:17 58:1,3	77:12 80:8	156:18
<b>based</b> 78:13	<b>Bernie</b> 118:5	60:14 70:23	83:12 86:10	<b>broker-dealer</b>
99:21 108:5	<b>best</b> 10:3,15,16	71:13 73:24	94:17	3:19 10:13
115:11 117:21	10:19 11:7	75:23 76:12	<b>Bradford</b> 3:9	27:18 41:20
117:23 155:12	12:9 31:8,11	88:12 91:16	<b>Bread</b> 21:5	42:9 46:18,23
<b>Baseline</b> 98:6	31:16,18 75:15	96:24 99:16,22	<b>break</b> 105:5	51:2 57:2
<b>basic</b> 124:25	76:6 82:19	100:10,18,22	107:4,4 118:4	85:12 91:6
<b>basically</b> 63:14	90:14 106:13	101:23 104:11	120:19 121:7	92:6,18 121:13
76:11 96:22	<b>Betsy</b> 2:13 6:17	106:8 110:5,12	<b>breakdown</b>	139:12 146:10
142:7	<b>better</b> 7:22 20:7	115:19 118:12	128:5 132:24	156:15
<b>basis</b> 9:5 31:16	59:2,3 67:5	124:11 139:16	<b>breakdowns</b>	<b>broker-dealers</b>
37:7	83:2,2,9 85:19	142:21 147:9	128:7	13:4 25:22,23
<b>battle</b> 64:5	85:21 93:18	152:20 165:13	<b>breaks</b> 93:14	26:4 30:7
<b>bear</b> 121:1 165:5	95:11 119:23	165:15 168:13	<b>Brian</b> 2:11	33:12,20 34:16
<b>bears</b> 119:21	120:16 121:10	<b>bite</b> 50:18	<b>bridge</b> 34:8	45:22 49:14
121:22	125:9 143:10	<b>Blair</b> 64:23	<b>brief</b> 14:20	51:14 52:15
<b>beauty</b> 40:16,18	150:22	<b>block</b> 49:24	16:16 57:25	55:20 70:20
	<b>beyond</b> 45:10,22	108:1	<b>briefing</b> 108:9	80:25 81:6
	<b>bid-ask</b> 102:18		<b>briefings</b> 99:3	84:6 121:17
	<b>bifurcation</b>		<b>briefly</b> 38:12,18	122:10
			38:21 138:13	<b>brokerage</b> 24:5
			<b>bring</b> 16:20	26:5,24,25

29:7,14 51:3 80:20 122:1 <b>brokers</b> 26:7 29:4 33:17 35:2 36:4 38:3 38:10 41:15 42:17 78:22 147:7 <b>brokers'</b> 33:16 <b>brother-in-law</b> 38:25 <b>Brothers</b> 14:2 <b>brought</b> 15:4 110:25 112:2,4 113:8 132:8,9 141:25 <b>bucket</b> 33:15 34:8 96:6 <b>buckets</b> 49:14 96:1 98:17,18 <b>build</b> 85:4 <b>building</b> 54:22 63:17 <b>builds</b> 97:12 <b>built</b> 93:11 <b>bulge</b> 72:14,14 <b>bulk</b> 16:22 51:1 <b>bullet</b> 165:22 <b>burdensome</b> 122:6 <b>burn</b> 83:5 87:23 <b>business</b> 4:5 5:16 6:19,20 6:24 8:5 13:25 16:9 59:17 61:11,12 62:14 63:2,23 64:2 68:5 69:14 70:20 71:20 72:24,25 74:10 74:15 79:10 84:11 86:19 87:22 133:25 150:8 154:5,18 156:9 157:2 170:3 <b>businesses</b> 8:11 8:18,19 89:11 137:19,22	<b>Butler</b> 77:14 <b>buy</b> 37:2 82:25 <b>buy-side</b> 66:10 <b>buying</b> 40:16 91:9 <hr/> <b>C</b> <hr/> <b>C</b> 3:1 4:1 <b>calibrated</b> 138:23 <b>call</b> 21:18 38:17 46:25 50:4,8 76:15,19,20 93:25 162:9 <b>called</b> 59:19 87:5 <b>campaign</b> 93:10 <b>Canadian</b> 110:2 <b>candid</b> 47:21 <b>candidates</b> 50:5 86:20 <b>cap</b> 20:19 58:7 61:3,14 63:2 64:25 68:5,5 78:18 87:8,10 89:15,20 95:20 <b>capital</b> 8:6 9:1 10:16,23 11:2 11:7,25 13:17 13:19,25 14:25 15:11 16:5,5 16:12 17:24 18:2,5 19:7 20:15,21 21:1 21:7 22:2 24:13 28:12 33:8 45:10 49:10 69:4 70:8,22 84:22 86:21 90:5 92:21 104:16 107:16 109:8,8 109:11,15,15 109:23 116:13 136:8 138:8 150:9 157:2 <b>capital-raising</b> 8:9 16:14 94:1 <b>capitalism</b> 87:16	<b>capitalized</b> 49:5 <b>Capitol</b> 150:19 <b>caps</b> 159:1,2 <b>care</b> 67:10 69:25 72:23 83:23 <b>career</b> 13:16 14:1 <b>carefully</b> 48:12 <b>caring</b> 9:14 <b>case</b> 23:18 25:12 27:9,12 31:23 31:24 32:1 36:15 41:19 44:18 48:8 53:8 68:1 86:7 89:18 91:6 92:5,6 121:23 126:9 133:5,18 134:10 144:9 144:12 145:7 163:13 <b>cases</b> 17:2 26:1 26:22 36:1 43:1 49:1 56:16 113:13 113:15 115:14 117:4,11 118:21 119:17 132:5,8 133:10 135:1,18,21,25 143:13 144:5 144:21 145:14 <b>cash</b> 49:17 62:13 <b>cashflow</b> 49:19 <b>catch</b> 123:14 <b>categorize</b> 136:16 <b>category</b> 69:8 137:4 145:25 <b>Catherine</b> 2:12 128:15 134:3 144:16 <b>caught</b> 154:23 <b>cause</b> 43:7 132:11 <b>caused</b> 66:9 <b>caution</b> 99:21 <b>caveats</b> 100:3 <b>CDIs</b> 148:18	<b>center</b> 98:12 127:4 <b>centers</b> 98:19 <b>central</b> 8:6 10:21 <b>cents</b> 75:9,10,10 <b>century</b> 154:25 <b>CEO</b> 19:19 66:18 <b>CEOs</b> 19:15 <b>certain</b> 31:23 45:20 80:8,9 108:2 110:21 122:2 140:2,3 141:2,15 <b>certainly</b> 7:21 15:4 19:2,7 23:20 24:22 28:13 33:2 35:23 37:5 48:20 50:4 57:13 73:6 83:19 95:10 111:24 117:3 124:15 126:3 140:22 151:4 156:23 158:20 162:20 166:2 170:8 <b>certainty</b> 35:14 147:13,13 148:17 151:23 151:25 155:18 161:10,20 <b>CERTIFICATE</b> 172:1 173:1 <b>certificates</b> 43:15 <b>certify</b> 172:8 173:4,12 <b>cetera</b> 54:22 89:15 94:14,14 114:11 <b>CFO</b> 54:22 <b>Chair</b> 2:3 57:23 58:4 60:1 65:22 72:8 73:22 77:11 <b>chairman</b> 5:8,8	6:3 7:3,4,14 9:20,24 14:11 146:18 162:7 <b>chairs</b> 14:9 163:11 <b>challenge</b> 15:18 38:3 55:19 65:7 92:17 93:22 <b>challenges</b> 4:13 8:17,22 26:22 36:18 99:21 <b>challenging</b> 48:16 64:15 93:21 <b>chance</b> 48:7,13 57:19 <b>chances</b> 22:4 <b>change</b> 98:16,21 99:17 104:10 104:21 147:19 159:7 161:22 <b>changed</b> 20:24 71:14 123:18 <b>changes</b> 20:9 86:18 95:25 100:11,20 104:12 147:16 169:1 <b>changing</b> 104:6 <b>channels</b> 46:12 46:18 54:11 <b>character</b> 36:10 36:11 90:10 <b>characteristics</b> 141:16 <b>characterize</b> 48:21 <b>charged</b> 147:15 <b>charity</b> 37:4 <b>chart</b> 60:13,15 61:2 <b>chasing</b> 131:18 <b>chasm</b> 40:22 <b>cheaper</b> 70:12 <b>cheaper/faster</b> 56:17 <b>check</b> 43:12 123:1,7
--	--	--	---	--



<b>checks</b> 114:16	121:24	140:12 143:15	126:4	<b>commission</b> 1:1
<b>cherry-pick</b>	<b>clients</b> 35:4	146:1,4,6	<b>colorable</b> 95:10	1:24 6:8,9 8:9
84:10	45:21 58:19	147:1 148:3,10	<b>combination</b>	35:8 55:13
<b>chief</b> 158:2	62:6 65:24	148:15 149:4	74:21	57:10 67:19,20
<b>choice</b> 37:4	67:6 69:8,9	150:3 151:3,7	<b>combine</b> 62:23	67:22 76:16
<b>choices</b> 11:19	79:3 81:15	151:11,13,16	<b>come</b> 15:19	95:12 98:17
<b>choose</b> 27:17	87:17,17,22	151:19,21,24	54:24 69:15	105:15 146:9
84:1,4	88:20 121:20	152:1 153:5,14	71:13 88:13	146:14 147:12
<b>choosing</b> 92:17	122:12 139:15	153:17,19,21	101:10 102:12	147:23 149:6
<b>Chorus</b> 163:20	<b>close</b> 9:11 23:11	154:2,21	106:18 114:16	150:16,24
169:6	28:19 34:1	155:20 156:21	120:15 125:4	154:8 155:15
<b>chose</b> 33:3	43:2 46:10	157:5,7,18	129:1 133:15	156:14,24
<b>chosen</b> 93:20	53:7,20 55:6	158:5,16 159:1	138:18 144:14	157:15 161:5
<b>Christensen</b>	104:17 128:1	159:13,15,17	148:16 150:17	162:8 164:12
21:20	132:20 140:1	159:21 160:8	153:3 169:22	164:15 168:14
<b>church</b> 117:24	143:12	160:14,23,25	170:2	168:19 172:11
<b>churning</b> 128:9	<b>closed</b> 17:1	161:2,7,9,13	<b>comes</b> 64:21	<b>Commission's</b>
141:21,24	<b>closely</b> 18:13	161:16,21,24	79:7,18 92:17	23:6
142:2,5,13	84:25 96:8	163:2,8,13,18	115:9 124:14	<b>Commissioner</b>
<b>circle</b> 118:2	126:7,14	165:1,6 166:10	125:19	5:12,13 9:21
<b>circumstances</b>	<b>closest</b> 66:22	166:19,23	<b>comfort</b> 18:25	9:22 12:11
133:3	<b>Closing</b> 3:22	167:12 168:5,7	35:7 54:8	14:15 18:14
<b>Cisco</b> 21:6	<b>clothing</b> 139:25	168:10,18,22	<b>comfortable</b> 8:2	57:24 58:5,13
<b>cite</b> 154:15	<b>clouds</b> 119:6	168:24 169:1,5	38:5 41:12	64:19
156:11	<b>club</b> 91:19	169:7,9,18	47:14 49:23	<b>commissioners</b>
<b>cited</b> 99:9	<b>clustering</b>	171:2,4	62:23	8:3
116:15 161:23	100:22	<b>co-managers</b>	<b>coming</b> 4:13	<b>commissions</b>
<b>cites</b> 156:7	<b>co-chair</b> 2:4,5	71:17	5:10 6:25	142:9
<b>civil</b> 112:5	4:2,5 7:2,5	<b>Coffee</b> 21:4	36:19 39:1	<b>commit</b> 136:23
<b>clarification</b>	9:20 12:11,15	<b>cognitive</b> 119:6	53:10 67:5	138:17
142:15 161:4	12:16 35:12	<b>coiner</b> 21:21	73:18 102:25	<b>commitment</b>
<b>clarify</b> 38:8	36:8,13 44:2,8	<b>collaborate</b>	146:18 167:4	31:13 32:13
146:10 156:14	44:11,14 47:4	164:16	<b>commend</b> 55:12	90:21
<b>clarity</b> 44:15	47:11 52:1,19	<b>collaboration</b>	57:14 130:17	<b>commitments</b>
57:1 161:19	52:22,25 53:3	126:19	<b>commended</b>	31:15
<b>class</b> 84:25 85:7	57:18 70:16	<b>collaborative</b>	47:19	<b>committee</b> 1:9
169:13	73:3 74:24	126:16 127:5	<b>comment</b> 41:21	4:16,22 7:10
<b>classic</b> 129:17	75:21 77:12	<b>colleague</b> 82:7	58:13 62:12	7:11 8:7,24
133:13,20	79:23 80:21	<b>colleagues</b> 17:8	64:3,19 87:15	9:12 10:1 14:9
<b>Clayton</b> 2:5 3:5	81:11 82:11,14	123:1	119:24	22:20 47:16
5:8,8 6:3 7:4,5	86:9 88:8,16	<b>collect</b> 110:13	<b>commentary</b>	57:24 69:6
9:24 21:19	89:3,6 90:1	111:5	67:17	71:25 79:8
<b>clean</b> 61:22	91:19,23 94:16	<b>collected</b> 98:2,5	<b>comments</b> 9:10	86:11 107:14
<b>clear</b> 25:6 79:25	105:22,24	98:6,7	14:19 57:25	107:18 146:13
<b>clearly</b> 40:17	106:20 107:1,9	<b>collecting</b>	58:4 59:6 65:9	149:12 154:6
82:1 125:15	107:12 114:7	110:10	80:12 99:23	154:18 155:11
152:9	114:10,22	<b>collection</b> 39:7	146:23 147:2,3	156:9 157:13
<b>client</b> 58:18	136:5 138:12	74:5 108:19	164:17,18	157:22 159:10
65:20 77:19	138:22 140:9	<b>collectively</b> 8:20	168:11,24	160:6,10

162:18 168:17 170:2 172:2 173:8 <b>committee's</b> 10:7 160:3 <b>committing</b> 127:23 <b>common</b> 24:12 124:19 <b>common-law</b> 132:10 <b>communicate</b> 36:4 <b>communication</b> 64:10 <b>communities</b> 24:8 26:23 33:5 <b>community</b> 16:2 16:21 18:24 24:4 25:13,17 26:13,16,17 27:20 28:15 30:9 32:16,21 33:20,21 37:6 40:15 41:14 45:1,5,11,16 45:21 52:18 54:12 56:6 57:4 63:24 80:11,14,18,22 81:1,7,8 85:13 87:2 93:15 94:2,11 118:6 119:2 121:10 121:14 <b>comp</b> 68:10 <b>companies</b> 1:10 4:9 8:10,12,22 9:1 10:4,8,22 11:8,22 12:1,4 12:19,22 13:3 14:24 15:3,7 15:11 16:4,15 16:20,24 17:22 17:23 18:4,9 18:19,22 19:2 19:3,14 20:25 21:1,3,9,12,13	21:16,24 22:1 22:5,7,9,16,17 22:21,22 24:8 24:15,21,23 26:15,15 27:1 37:3 38:16,17 38:23,24 39:20 40:21 41:9 43:21 44:1 47:17,20,23 48:6,7,8,19,22 50:4,11,22 51:8,9 53:11 53:13 55:5,8 55:14,23 56:17 60:8 61:2,6,16 61:17 62:9 64:18 65:2,4 65:17 68:15,20 70:22 72:7 79:5 83:22,24 83:24 86:16,21 88:12,19 89:22 90:10 92:13,20 95:19 139:21 164:1,1 172:3 173:9 <b>companies'</b> 71:23 <b>company</b> 18:21 19:19 20:1,12 20:17 22:25 26:20 28:4 29:19,20 30:19 32:11,14 36:11 36:20,22,24 40:18 44:25 45:15 54:6,20 56:14 58:16 59:1,1 60:11 61:8,20,23,24 62:11 64:1 66:4,17,18 68:11,14,22 70:13 71:1 72:1,3 74:2 77:23 80:17 83:11,18 84:4 84:20 85:18	87:11,18,19 88:25 89:23 90:3,3,23 91:10 92:11 93:5,24 141:13 144:21 167:6 <b>company's</b> 28:5 40:23,23 68:2 <b>compared</b> 172:13 <b>comparing</b> 68:3 <b>comparison</b> 39:25 105:6 <b>compensation</b> 156:16 <b>competition</b> 84:15 <b>competitors</b> 52:15 74:13 <b>complain</b> 69:16 <b>complaint</b> 126:18 137:12 <b>complaints</b> 111:15 128:4 137:25 <b>complete</b> 23:1 48:16 62:2 80:3 105:11 172:12 173:5 <b>completed</b> 17:11 80:2 87:11 <b>completely</b> 140:8 <b>completing</b> 29:18 46:14 <b>completion</b> 17:1 83:15 <b>complex</b> 132:4 <b>compliance</b> 30:11 33:16 34:15,18 35:14 35:15,16,21 37:14 42:7,17 43:7 <b>complicated</b> 12:21 <b>component</b> 20:22 24:2,10 24:14,19 25:8	28:18 35:23 37:1 39:12 41:10 45:23 56:19 94:15 140:6 <b>comprehensive</b> 150:23 157:4 <b>compromise</b> 138:10 150:21 <b>concept</b> 151:8 151:12,17 <b>concepts</b> 160:9 <b>concern</b> 29:11 37:8 47:4,11 77:11 100:15 <b>concerned</b> 34:21 36:2 64:7 75:7 <b>concerning</b> 134:25 146:8 <b>concerns</b> 34:7 34:11,12,24 43:7 44:5 81:9 98:10 102:13 <b>concludes</b> 70:14 <b>conclusion</b> 68:24 69:1 129:3 <b>conclusions</b> 106:3 <b>concrete</b> 56:24 <b>conditioned</b> 116:9 <b>conduct</b> 39:4 122:4 <b>conducting</b> 133:24 134:14 <b>conference</b> 108:16 131:23 <b>conferences</b> 125:24 <b>confidence</b> 7:18 10:21 12:7 46:20 57:5 <b>confident</b> 45:19 114:18 <b>confidential</b> 62:4 65:16 <b>confirm</b> 30:10 169:16	<b>confirmation</b> 7:21 8:16 <b>confirmed</b> 86:7 <b>confluence</b> 63:4 <b>Congratulations</b> 5:9 <b>conjures</b> 167:3 <b>connect</b> 91:12 <b>connection</b> 4:24 95:2 117:22 118:4 136:11 166:1 <b>consensus</b> 67:21 158:2 161:25 162:1 <b>consequence</b> 135:5,15 136:1 <b>conservative</b> 34:15 <b>consider</b> 10:12 35:24 36:2 61:9 65:11 85:15 144:18 149:14,23 164:12 168:15 <b>consideration</b> 3:18 34:25 35:1 158:11 <b>considering</b> 160:19 <b>considers</b> 85:15 <b>consistent</b> 99:10 111:16,23 112:1,15 113:19 115:6 116:6 132:24 136:22 156:21 <b>consistently</b> 17:21 115:5 <b>consolidated</b> 75:1 <b>constant</b> 71:14 <b>constantly</b> 66:3 89:10,21 <b>construction</b> 18:12 <b>consume</b> 40:23 <b>consumer</b> 92:8 <b>contemplating</b>
--	---	---	--	---

66:17	45:25	140:17	<b>crowd</b> 32:15,20	<b>data</b> 4:18,23
<b>content</b> 45:4	<b>convert</b> 37:18	<b>court</b> 112:5	32:21 33:5,9	11:13 57:11
<b>context</b> 38:22	<b>converting</b> 28:2	131:7 147:13	33:23 37:16,19	65:25 66:4,5,5
70:18 92:1	<b>conviction</b>	<b>courts</b> 131:4	40:5 41:2	67:4 88:13
126:25	133:18	<b>cover</b> 72:12,12	46:13 56:2,20	98:1,4,6,17,22
<b>continually</b>	<b>convinced</b>	130:11	<b>crowdfunding</b>	98:24 99:4,6
111:4	150:13	<b>coverage</b> 64:24	24:2,14,14,17	99:22 102:15
<b>continue</b> 6:11	<b>cooperation</b>	66:1 68:14	24:19,23 25:3	102:21 103:3,4
10:23 20:4	55:15 57:13	72:1,5	25:7,8 26:13	103:5,6,9,18
22:17 23:2	<b>cooperatively</b>	<b>covered</b> 153:1	41:10 46:13	103:21 107:15
24:7 25:5	135:25	<b>CPAs</b> 134:25	109:18 130:12	107:17 108:5,5
29:10 32:4	<b>copy</b> 122:19	<b>crafting</b> 125:2	131:24 139:18	108:9,18,19
36:14 42:24	146:21,22	<b>Craigslist</b>	139:20	110:5,6,6,10
44:22 62:6	164:17	134:17	<b>crowdsourcing</b>	111:1,3,4,5
74:11 82:20	<b>CorpFin</b> 6:17,18	<b>crazy</b> 91:14	24:2	115:8,19
83:9 91:13	<b>corporate</b> 14:10	<b>create</b> 10:16,18	<b>crystal</b> 83:6	119:14 123:23
94:19 131:9	61:12 87:16	121:12 167:21	<b>culture</b> 16:18	124:4,12,17,23
135:16 137:21	132:9	<b>created</b> 66:11	<b>curious</b> 128:16	127:8 130:11
<b>continued</b> 57:10	<b>corporation</b>	118:8 137:18	<b>current</b> 12:22	154:22
66:14 67:11	5:22 136:14	<b>creates</b> 161:19	51:13 78:2	<b>data-based</b>
70:11 99:15	<b>correct</b> 31:9,19	<b>creating</b> 55:13	80:13 86:15	109:1
138:7	77:22 90:13,17	72:4 92:13	90:9,9 96:19	<b>data-driven</b>
<b>continues</b> 24:2	148:6 154:3	109:8	115:9 146:10	21:14 22:8
66:8 74:19	<b>correctly</b> 58:25	<b>creation</b> 8:15	156:14 158:18	108:20
<b>continuing</b>	<b>correspond</b>	11:7	<b>currently</b> 13:1	<b>date</b> 22:21 23:5
107:17 131:12	59:14	<b>credential</b> 43:10	13:13 50:10	23:9 27:5
<b>continuous</b> 94:1	<b>cosmetics</b> 37:2,3	<b>credibility</b> 39:2	81:25 93:8	63:13 172:5,16
<b>continuously</b>	<b>cost</b> 11:17 47:18	<b>Credit</b> 14:1	97:5 98:5	173:18
59:10	48:2 50:13	<b>credits</b> 131:12	110:10 156:22	<b>dating</b> 134:19
<b>contrarian</b>	70:11 101:14	<b>creep</b> 108:24	159:5	<b>daughter</b> 77:17
63:11	101:20 105:6	<b>crime</b> 144:9	<b>customer</b> 78:5	<b>daughter's</b>
<b>contrary</b> 101:4	<b>costs</b> 62:8 101:9	<b>criminal</b> 132:16	<b>customers</b> 78:14	19:20
<b>contributed</b>	101:11,12,14	132:17 133:1	<b>cut</b> 74:11,11,11	<b>Dave</b> 99:1,1
73:14	101:16 102:21	<b>criteria</b> 26:11	138:16	102:14 103:3
<b>contributor</b> 41:7	<b>counsel</b> 6:23	43:25 45:13,18	<b>cutting</b> 105:4	<b>David</b> 2:17
<b>control</b> 95:24	39:6	49:21 50:7	<b>cycles</b> 18:5	98:25 104:25
99:17 100:14	<b>counterparts</b>	51:25 95:20	<b>cynical</b> 91:17	<b>Davis</b> 2:8 6:22
<b>controlling</b>	126:7 127:6	<b>critical</b> 10:7		154:10,14,23
97:23	<b>country</b> 118:15	20:22 24:19	<b>D</b>	155:2 156:5,23
<b>controversial</b>	122:14 127:2	56:19 92:14	<b>D</b> 4:1 144:22	157:6,11
97:11	139:1	109:22	145:13	158:24 159:2
<b>conventional</b>	<b>couple</b> 13:4 56:3	<b>critically</b> 25:21	<b>D.C</b> 1:25 110:1	160:13,18,24
29:24	87:5 99:11	<b>Cromwell</b> 82:3	172:6 173:7	161:1,4,10,15
<b>conversation</b>	100:2 110:1	<b>crooks</b> 131:18	<b>D.F</b> 62:12	161:17 162:6
74:1 94:19	119:17 131:22	<b>cross-border</b>	<b>daily</b> 68:18	162:12,17,23
137:6	166:10 169:10	126:5	95:21	170:17,20,23
<b>conversations</b>	<b>course</b> 17:7,16	<b>cross-reference</b>	<b>Dallas</b> 87:5	<b>day</b> 8:5 64:20
39:10	20:8 22:6 44:7	158:7,17	<b>Dan</b> 165:14	65:19 67:7
<b>conversion</b>	135:6 136:9	159:12	<b>dark</b> 102:5,6	69:14,20,20,21

74:17 75:11 87:18 149:24 170:11 <b>days</b> 8:1 47:18 75:20 122:3 <b>deal</b> 20:1 23:16 27:19 32:13 38:25 40:5 53:19,21 58:21 59:18,24 60:23 61:4 68:3,9,10 71:16 72:2,20 79:13 80:8,10 87:6,11 94:12 <b>dealers</b> 35:20 <b>deals</b> 18:25 37:24 38:9 52:16 55:21,22 57:7,13 58:12 60:19,22 61:5 61:7 68:4,7,7 71:4,7,8 78:16 78:18 80:1,6,7 87:4 93:7 <b>debate</b> 73:16 105:8,19 167:7 <b>decade</b> 60:6 70:3 142:3 <b>Deceptive</b> 132:9 <b>decide</b> 153:4 <b>decided</b> 143:24 146:16 <b>decimalization</b> 67:14 <b>decipher</b> 140:4 <b>decision</b> 63:25 89:16 166:9 <b>decision-maki...</b> 108:23 <b>decisions</b> 108:20 108:21,21 <b>decline</b> 4:7 73:15 <b>declined</b> 33:12 33:21 38:10 60:8 <b>dedicated</b> 7:25 10:1 <b>deem</b> 79:5 81:8	<b>deep</b> 56:8 <b>deeper</b> 103:7,11 <b>default</b> 145:3 <b>defer</b> 153:11 <b>definitely</b> 87:2 117:10 162:12 <b>definition</b> 117:20 124:10 140:18 161:22 <b>definitions</b> 124:12 <b>definitive</b> 151:22 <b>degree</b> 18:24 28:1 34:13 54:7 <b>delay</b> 121:25 158:20 163:12 <b>delete</b> 166:5 <b>deleted</b> 147:21 <b>deliberations</b> 9:8 <b>deliver</b> 20:7 29:21 30:7 <b>delivered</b> 30:12 <b>delivering</b> 19:11 20:6 <b>delve</b> 14:4 <b>demand</b> 30:8 58:23 65:20,23 65:23 69:10 80:7 91:1 <b>demanding</b> 69:18 <b>democratic</b> 91:15 <b>democratize</b> 15:22 <b>demonstrate</b> 145:6 <b>denied</b> 116:7 <b>denominator</b> 124:19 <b>department</b> 13:13 113:1 121:19,24 122:4 141:4 <b>departure</b> 128:1 128:2	<b>depend</b> 36:10 <b>dependent</b> 69:17 <b>depository</b> 87:1 88:14 <b>depth</b> 100:13,13 100:15 <b>depths</b> 101:17 <b>deputy</b> 5:23 6:1 <b>DERA</b> 103:20 <b>describe</b> 14:22 <b>described</b> 158:6 <b>deserving</b> 21:13 <b>designated</b> 37:9 <b>designed</b> 37:8 106:12 <b>desire</b> 4:23 75:19 <b>desk</b> 67:16 <b>despite</b> 36:20 46:4 <b>destined</b> 56:14 <b>detail</b> 94:24 133:9 147:18 149:13 <b>detailed</b> 157:12 158:4 <b>determine</b> 16:20 93:19 139:16 <b>determined</b> 22:12 31:2 32:24 <b>determining</b> 120:3 156:15 <b>deterred</b> 109:20 <b>developed</b> 77:3 <b>development</b> 157:3 <b>developments</b> 24:7 <b>devote</b> 144:10 <b>devoted</b> 32:24 <b>dialogue</b> 150:25 <b>difference</b> 43:14 56:17 72:17 74:4 91:1 107:19 152:25 <b>differences</b> 86:1 86:3 <b>different</b> 16:14	19:16 32:11,12 36:17 50:3 58:2 73:1 80:7 86:4 89:13 90:2 93:23 103:12 105:3 106:17,17 124:17 128:22 129:2 137:6 150:6 152:24 162:25 167:6 <b>differentiate</b> 121:6 <b>differentiation</b> 26:3 <b>differently</b> 51:15 95:9 <b>difficult</b> 42:12 46:22 75:19 81:19 98:20 164:7 169:21 <b>difficulty</b> 81:13 <b>dig</b> 41:23 <b>digest</b> 54:17 <b>digging</b> 105:17 <b>Dilemma</b> 21:20 <b>diligence</b> 39:5 39:17 42:2 56:8 92:14,19 130:1 <b>diligently</b> 137:16 138:9 <b>dilutes</b> 167:13 <b>diminished</b> 66:8 <b>dinner</b> 137:1 <b>dinosaurs</b> 154:20 <b>direct</b> 153:7 <b>directed</b> 162:4,7 <b>direction</b> 173:14 <b>directly</b> 59:7 125:19 <b>director</b> 5:23 6:1 6:4 13:18 <b>directors</b> 6:18 <b>disagree</b> 166:21 <b>disagreed</b> 130:19 <b>disappointed</b>	15:5 155:6,6 <b>disbursement</b> 122:1 <b>disclosure</b> 22:25 30:14,17 47:12 54:5 62:5 <b>disconnect</b> 56:3 <b>discount</b> 164:23 165:5 <b>discounted</b> 49:17 <b>discuss</b> 10:11 16:19 164:23 <b>discussed</b> 4:7 12:18,20 86:11 107:19 163:24 164:11 <b>discussing</b> 142:16 <b>discussion</b> 6:12 25:12 35:21 74:16 108:11 140:19 150:18 167:1 170:9 <b>discussions</b> 9:4 10:7 11:10 21:17 <b>disentangle</b> 104:4 <b>disinclined</b> 167:10 <b>display</b> 96:11 97:13,18 <b>displayed</b> 45:2 97:15,21 <b>disproportion...</b> 70:6 143:6 <b>disrupt</b> 21:25 <b>disruption</b> 21:18 39:13 <b>disruptive</b> 21:21 82:24 <b>dissemination</b> 57:11 <b>distinguish</b> 144:23 <b>distributing</b> 35:20 <b>distribution</b>
---	--	--	---	--

25:10 33:21 55:18 <b>dive</b> 103:11 <b>diversified</b> 61:11 173:20 <b>division</b> 3:11,12 5:21 6:4 14:10 162:4 <b>doable</b> 162:20 <b>document</b> 144:20 154:15 155:22 158:19 <b>documentation</b> 145:15 <b>documented</b> 156:10 <b>documents</b> 39:7 39:8 156:10 <b>doing</b> 8:11 19:17 38:5 42:1 50:13 56:5 66:18 69:23 79:13 81:15 91:4 104:2 121:11 129:12 136:8 137:23 142:10 144:24 149:20 <b>dollar</b> 95:7 115:15,15 <b>dollars</b> 21:14 28:15 61:15 67:19,22 114:11,12,15 <b>donate</b> 37:3 <b>double-edged</b> 51:20 <b>doubled</b> 87:13 <b>doubt</b> 40:11 <b>doubting</b> 123:9 <b>dovetailing</b> 90:23 <b>downward</b> 111:18,21,24 113:18 115:5 <b>dozen</b> 122:15 124:22 143:13 <b>draft</b> 3:18 146:6 146:21 160:10	162:1 <b>drafting</b> 160:5 <b>dramatic</b> 60:11 <b>dramatically</b> 19:16 71:14 89:9 <b>draw</b> 129:2 <b>drive</b> 14:16 15:23 16:4 21:23 25:18 31:1 33:23 44:23 69:10 88:6 <b>driven</b> 15:15 17:15 34:14,16 <b>drivers</b> 61:25 73:10 <b>drives</b> 88:5 <b>driving</b> 16:12 28:14 73:20 80:25 87:25 <b>dropped</b> 112:10 166:12 168:9 <b>dropping</b> 84:10 160:15 <b>drove</b> 32:20 <b>DTC</b> 28:21 81:18 <b>DTC-eligible</b> 43:2 <b>dual</b> 109:6 <b>due</b> 39:4 56:8 81:9 130:1	<b>early</b> 15:19 18:5 18:7,22 19:8 20:13,21 23:6 30:9 48:22 77:10 82:22,25 103:2 106:14 107:4 170:19 <b>early-stage</b> 16:5 54:19 55:4 85:7 <b>earn</b> 17:10 61:19 <b>earned</b> 47:22 48:5 <b>earth</b> 154:20 <b>ease</b> 29:15 <b>easier</b> 81:20 136:9 140:4 <b>easily</b> 120:16 124:24 150:13 <b>easy</b> 135:22 <b>EBITDA</b> 50:9 50:10 <b>echo</b> 9:9 <b>economic</b> 3:12 10:16 65:4 104:5 <b>economically</b> 67:12 <b>economics</b> 64:19 69:23,24 71:16 71:18 74:22 <b>economies</b> 8:19 <b>economy</b> 8:14 8:20 12:2 112:13 <b>ecosystem</b> 13:1 35:9 58:6,7 65:9 72:5,22 73:3 74:8 88:20 106:7 <b>edge</b> 152:10,21 <b>educate</b> 134:4 134:21 <b>educated</b> 121:10 166:8 <b>education</b> 30:23 44:12,17 57:12 84:6 131:10,12 136:25 137:10	<b>educational</b> 57:8 <b>Edwards</b> 2:9 102:23 106:11 <b>effective</b> 107:16 <b>effectively</b> 11:21 33:9 93:11 94:3 97:17 <b>effects</b> 104:5,6 105:1 <b>efficacy</b> 11:14 <b>efficiency</b> 70:11 <b>efficient</b> 19:11 20:6 55:11,14 69:3 109:8 135:21 <b>efficiently</b> 26:9 <b>effort</b> 9:19 15:22 24:17,24 25:3 25:7,8 30:6 32:15,24 33:9 37:15 45:15 46:13,20 56:8 57:8,10,15 95:13 152:4 157:15 <b>efforts</b> 11:21 15:21 31:8,12 31:16,18 36:21 82:19 90:15 108:8 109:21 109:22 130:17 131:10 <b>egg</b> 107:24 <b>egregious</b> 115:14 117:12 <b>Eichler</b> 3:9 13:8 53:6 57:23 60:1 70:24 73:22 75:5 76:4 77:15,18 77:22,25 78:4 78:7,11,18,21 79:22 86:23 88:11 89:2,5,8 90:13,17 94:22 <b>eight</b> 98:1 <b>either</b> 10:17 12:22 25:7 33:16 40:22	47:16 56:13 78:20 81:19 115:14 116:9 116:25 119:4 121:19 127:14 135:12 142:1 144:5,19 154:7 <b>elder</b> 118:18,21 120:19 121:20 122:12 124:22 135:3 <b>elderly</b> 135:9 143:5 <b>eligibility</b> 28:21 <b>eliminated</b> 75:2 <b>Elio</b> 23:15,21 27:10,17 28:1 28:6,17 29:6 29:18 37:18 40:1,7 81:14 92:23 <b>Elio's</b> 27:23 33:7 <b>else's</b> 51:12 <b>emailed</b> 82:17 <b>embarrassed</b> 131:3 <b>embarrassment</b> 120:23 131:8 <b>embrace</b> 26:20 55:4 <b>embraced</b> 19:14 <b>emerging</b> 1:10 8:22 9:1 10:8 14:24 17:23 172:3 173:8 <b>emphasize</b> 11:12 25:13 <b>employees</b> 20:16 20:20 <b>emulate</b> 32:6 <b>enact</b> 147:20 148:8 150:1 151:21 152:2,3 155:16 157:24 161:5,8 <b>enacting</b> 149:17 <b>enactment</b> 149:15 <b>encounter</b> 33:10
	<b>E</b>			
	<b>E</b> 3:1 4:1,1 107:8,8 172:8 <b>E*Trade</b> 51:5 <b>eager</b> 107:14 <b>ear</b> 137:2 <b>earlier</b> 13:16 26:14 51:12 54:22 57:12 79:18 159:16 <b>earlier-stage</b> 51:7,9 53:14 79:5 <b>earliest</b> 154:12 154:21			

<b>encourage</b> 11:6 104:20	45:8 53:19 141:16	155:21 167:9	139:2 141:8 158:12 159:9	103:17 106:10 112:1
<b>endeavor</b> 18:22	<b>ensures</b> 18:24	<b>establish</b> 164:5	<b>examples</b> 18:5	<b>expectations</b>
<b>ends</b> 162:18	<b>ensuring</b> 138:4	<b>established</b> 27:6 45:7	70:25 117:12	88:5
<b>endure</b> 56:7,8 57:5 81:24	<b>enter</b> 84:16	<b>estate</b> 32:16,17 32:18 128:25	127:1 133:5 135:1	<b>expected</b> 29:4 33:2 48:9
<b>energize</b> 37:5	<b>entered</b> 105:3	134:25	<b>excellent</b> 83:10	<b>expend</b> 47:9 48:10
<b>energized</b> 32:20	<b>entering</b> 142:20	<b>estimated</b>	<b>exception</b> 97:3 168:2	<b>expensive</b> 55:11 83:15
<b>energy</b> 47:9 48:10 77:23	<b>enthusiast</b> 37:7	118:17	<b>exceptional</b>	<b>experience</b>
<b>enforcement</b>	<b>enthusiasts</b> 24:9 28:3	<b>et</b> 54:22 89:15 94:14,14 114:11	18:19,21	16:23 28:25 30:8 52:12 90:2 119:25
3:15 4:21	<b>entire</b> 12:2 135:10 165:8	<b>ethnicity</b> 117:25	<b>exceptions</b> 99:11	<b>experiences</b> 14:4 14:22 15:1,6 17:4,6
10:11 11:21	<b>entirely</b> 33:18 73:18 101:6	<b>European</b> 76:10	<b>excess</b> 144:9	
108:4,7 109:13	<b>entities</b> 10:19 52:20	<b>evaluate</b> 107:15	<b>exchange</b> 1:1,24 30:17 73:19	
109:21 110:3,7	<b>entity</b> 40:6	<b>evens</b> 83:3	80:17 83:19	
110:8,25 111:5	<b>entrepreneurs</b>	<b>event</b> 121:22	97:19 156:19	
112:2,3,3,7,8	15:18	<b>events</b> 137:1,2,3	165:9,18 167:2 167:23 172:11	<b>experiencing</b>
112:11 113:6	<b>enumerate</b>	<b>ever-changing</b>	166:25 168:18	81:25 125:20
113:20 115:2,4	39:16	9:16	<b>exchanges</b> 96:25	<b>expertise</b> 120:7
115:12,21	<b>environment</b>	<b>everybody</b> 4:2 9:23 27:11	97:6,21 102:3	<b>explain</b> 31:10 52:6 75:23 120:25
116:17 118:22	9:15 62:1,7	58:20 64:7	102:4 165:19	
119:21 123:18	63:21 65:10	65:13 83:12	166:25 168:18	<b>explanatory</b>
124:25 125:21	72:5 77:6	91:4 108:18	<b>excited</b> 6:1,10	166:16
125:24 127:6	112:14	124:23	<b>exciting</b> 19:25 26:21	<b>express</b> 14:17 30:3
127:17,24	<b>equal</b> 63:14	<b>everybody's</b>	<b>exclusively</b>	
129:14 130:13	<b>equally</b> 15:25 82:11	151:1	39:13	<b>expressed</b> 14:25 22:23 55:9 82:7
131:15 132:15	<b>equation</b> 137:14 137:14	<b>everyone's</b> 109:4	<b>excuse</b> 89:5 166:14	
137:11 138:14	<b>equity</b> 13:19,24 59:17 61:10,13	<b>evidence</b> 43:21 83:21 101:3 125:20	<b>executing</b> 96:13	<b>expresses</b> 94:5
138:19 140:5,8	61:13 62:15,16	<b>evolve</b> 24:3	<b>execution</b> 75:15 76:8	<b>expressly</b> 148:12
141:25 155:9,9 155:14	89:14 91:13	<b>exact</b> 88:13	<b>executive</b> 13:9	<b>extend</b> 14:14 47:14
<b>engage</b> 12:4	<b>equity-type</b>	<b>exactly</b> 30:20 35:10 36:12 39:16 47:13	<b>exemption</b>	<b>extensive</b> 32:14 93:10
21:16 24:3,8	62:21	82:6,7 83:17	145:25 167:10	<b>extent</b> 28:4 44:12,16 47:6 101:1 130:13
24:23 26:15	<b>equivalent</b> 20:14 20:15 30:16	86:7 131:19 142:6	<b>exemptions</b>	<b>extraordinarily</b>
27:17 32:15,15	52:4 126:13	<b>examine</b> 10:9 11:22	164:9,14	118:23 126:16
39:9,10 41:13	<b>eREIT</b> 23:22	<b>example</b> 20:12 40:8 41:12	<b>exercise</b> 80:7 99:20	<b>extravagant</b>
45:4 46:22	<b>eroded</b> 66:8	63:23 64:16	<b>exist</b> 139:20 167:23	133:17
57:3 93:14,20	<b>especially</b> 30:14 124:4,14	71:20,21 92:23	<b>existence</b> 85:25 170:11	<b>extremely</b> 26:21 41:18 46:1 64:12 67:18 85:20
<b>engaged</b> 14:23	<b>essential</b> 64:9 130:21	96:13 109:17	<b>existing</b> 167:24	<b>eye</b> 127:11 128:14 140:1
30:6 80:14	<b>essentially</b> 52:3 52:23 67:23	110:23 124:21	<b>exists</b> 107:20	
83:22 110:10	97:16 151:6	126:8 135:7	<b>exit</b> 61:22 63:2	
<b>engagement</b>			<b>expanded</b> 8:13	
10:25 11:1			<b>expect</b> 9:5 74:2	
<b>engaging</b> 43:25				
<b>engines</b> 12:2				
<b>English</b> 151:19				
<b>enhance</b> 158:21				
<b>enjoyed</b> 92:25				
<b>ensure</b> 19:21				

<b>F</b>				
<b>F</b> 1:25 107:8	99:5 102:22	<b>fewer</b> 20:16	<b>financings</b> 93:4	33:3 34:1 49:9
<b>face</b> 5:16 8:23	103:22,25	100:20	<b>find</b> 20:5 24:11	57:9 58:15
69:14 121:23	104:9 140:24	<b>Fidelities</b> 76:17	36:6 37:12	62:18 76:4
<b>Facebook</b> 45:2	158:14	<b>Fidelity</b> 51:6	66:22 87:18	82:10 89:14
<b>faced</b> 36:18	<b>fascinating</b>	<b>field</b> 96:24	89:21 124:13	95:4 96:6,15
<b>facilitate</b> 8:14	26:14 27:19	142:21	124:18 134:19	98:14 100:4
13:1 27:3 69:4	<b>favor</b> 97:21	<b>fields</b> 97:20	146:12 164:9	102:23 104:22
<b>facilitated</b> 8:25	148:17 163:19	<b>fig</b> 145:24	<b>finder</b> 10:13	107:13 111:9
<b>facilitating</b> 6:12	169:5	<b>figure</b> 68:3	<b>finders</b> 3:20 5:4	122:19 127:12
8:5,9 11:25	<b>favorable</b> 63:4	111:16 166:4	9:2 146:8,9,14	127:16 133:10
107:16	63:20	170:8	<b>finding</b> 15:11	143:11 146:7
<b>facing</b> 8:17	<b>FBI</b> 144:1,7	<b>figuring</b> 105:18	80:6 85:1,7,8	146:22 147:17
92:20	<b>fear</b> 38:5 77:1	<b>File</b> 172:4	88:19,25 90:10	147:20 156:6
<b>fact</b> 4:8 19:25	<b>feasible</b> 48:1	<b>filed</b> 23:11	<b>fine</b> 53:6 160:23	157:14 160:18
33:3 34:16	86:14,16	113:13 126:11	160:25	161:23
46:1,4 50:1	<b>features</b> 62:3	144:22 145:13	<b>finer</b> 79:1	<b>fit</b> 36:9 49:20,21
51:23 59:15	<b>February</b> 20:17	<b>filing</b> 62:4 81:21	<b>fines</b> 113:1	50:6,22 51:16
82:9 126:21	107:14 146:15	<b>filings</b> 65:16	114:3	<b>five</b> 13:23 59:2,4
141:1 167:16	163:23	<b>fill</b> 114:15	<b>finish</b> 53:4 56:21	75:10 98:19
<b>factors</b> 61:9	<b>federal</b> 126:7	<b>filling</b> 103:24	<b>FINRA</b> 34:18	118:17 125:15
97:24	131:7 132:2	<b>filter</b> 39:2 67:5	35:7 37:23	127:9 128:13
<b>failed</b> 46:9 48:10	<b>federal-state</b>	<b>final</b> 18:15 26:12	38:5,7 41:22	158:11,15
<b>failing</b> 134:1	143:16	32:8 53:7 93:9	41:25 43:11	<b>fix</b> 151:6
<b>failure</b> 80:3	<b>Feds</b> 143:17,19	154:6 170:15	57:6 81:10,20	<b>fixed</b> 92:3
128:8	144:1,1	170:17	157:15	<b>fixed-price</b>
<b>failures</b> 60:11	<b>fee</b> 47:22	<b>finalizing</b> 5:3	<b>firm</b> 13:10 15:15	54:15
<b>fair</b> 4:22 69:3	<b>feedback</b> 41:18	<b>finally</b> 5:2 9:9	17:25 22:2,12	<b>flavor</b> 134:2
123:15 168:5	92:15 93:24	17:13 56:22	31:12,14 59:13	<b>flexibility</b> 24:21
<b>fairly</b> 25:4 33:6	<b>feel</b> 7:25 8:1,2	97:10 101:25	60:3 62:23	97:7
<b>fall</b> 120:16 121:1	17:16 32:6	<b>finance</b> 5:22	63:16 77:1	<b>floor</b> 46:7
121:4	38:4 39:19	12:24 14:10	78:6 86:15,19	<b>Florida</b> 78:13
<b>fallen</b> 118:18	46:17 47:22	18:7 61:12	90:21 133:23	<b>flow</b> 49:18 62:13
129:6	49:23 51:22	121:4 136:15	<b>firm's</b> 13:13,14	64:10 67:25
<b>familiar</b> 154:11	58:21 73:12	<b>financed</b> 20:13	13:24	<b>flows</b> 4:6
<b>familiarity</b>	80:23 81:14	21:9 134:15	<b>firms</b> 4:11 22:14	<b>fly-over</b> 76:20
30:10	82:22 84:5	<b>finances</b> 119:8	61:14,19,22	<b>flying</b> 76:21
<b>family</b> 26:1,1	85:24 90:11	<b>financial</b> 13:10	63:16 64:22	<b>focus</b> 8:7,9
59:9,10 61:14	94:2 108:13	13:25 62:5	67:10,22 69:22	66:11 78:22
89:15	114:25 120:23	71:2 111:20,25	70:3,7 71:10	87:1 94:25
<b>family-type</b> 49:7	163:8	113:8 118:15	72:11 74:7	95:19 99:15
<b>fan</b> 37:7	<b>feeling</b> 76:1	118:18,21	76:14 77:8	101:8 125:16
<b>fans</b> 24:8 26:19	<b>feels</b> 20:10 38:7	120:1,20	80:20 111:15	138:14
26:23 28:3	168:16	121:21 122:12	127:14,18,18	<b>focused</b> 14:21
45:11,16	<b>fees</b> 17:10 48:5,5	124:22 125:16	142:1 145:21	19:10 73:4
<b>fantastic</b> 62:3	<b>fell</b> 33:15	144:9	<b>first</b> 5:7 7:13,15	89:12 119:12
<b>FAQs</b> 148:18	<b>fellow</b> 8:3	<b>financials</b> 87:21	7:17 13:8 14:6	127:24,25
<b>far</b> 4:19 43:8	<b>felt</b> 29:22 45:20	119:7	14:6 18:19	164:1
65:11 88:23	48:12 53:11	<b>financing</b> 18:21	27:10 28:23	<b>focuses</b> 58:7
	155:9	71:9 87:12	29:1,20 32:5	97:13 103:24

110:3	<b>fortunate</b> 59:18	128:11 130:18	30:13	<b>generating</b>
<b>focusing</b> 78:17	<b>Fortunately</b>	130:20 132:8	<b>fund</b> 76:10	53:16 56:20
104:8	81:23	132:10,12	133:17	75:4
<b>folks</b> 91:7 128:5	<b>forum</b> 150:8	134:3,7,14	<b>funding</b> 72:25	<b>generation</b>
130:23 138:19	156:9 167:17	135:8,11	84:22 129:22	53:13
156:20	<b>forward</b> 4:18,25	136:12,12,17	<b>fundraising</b>	<b>getting</b> 23:11
<b>follow</b> 17:5	5:10 6:25 9:7	136:23,24	22:24	28:21 34:9
18:17 34:18	11:9,19,20	137:7 138:17	<b>Fundrise</b> 23:23	38:23 42:16
65:2 72:13,16	12:8,10 14:16	138:19 142:17	<b>funds</b> 25:25	57:13 58:16
82:14 84:17	24:10 54:5	142:18 143:2,3	91:13 141:2	64:5 80:19
105:16 158:6	64:6 107:2	144:18,25	<b>further</b> 6:12	81:13 82:25
<b>follow-on</b> 71:21	130:10 153:13	145:15 166:1	8:14 14:5 15:9	85:17 90:12
90:6	<b>foster</b> 70:22	<b>frauds</b> 110:24	18:16 57:20	92:8 94:12
<b>follow-through</b>	<b>found</b> 10:2	116:16 117:10	96:21 99:23	104:1 113:2
72:10,18,19	20:23 24:15	117:10 119:22	173:12	119:23 130:23
<b>following</b> 88:8	45:25 55:25	120:12 121:9	<b>future</b> 20:14	143:10 147:24
112:20 144:15	113:6 165:14	129:12,13	28:5 62:25	<b>girl</b> 170:25
164:2	<b>founded</b> 59:9	134:24 135:4,6	77:5 150:15	<b>give</b> 16:17 44:4
<b>follows</b> 10:20	<b>founder</b> 15:14	135:12	151:22 161:6	48:19 70:24
58:14	18:11	<b>fraudster</b> 117:21		71:21 76:6
<b>fond</b> 58:22	<b>founding</b> 13:23	118:6 144:24	<b>G</b>	108:7 109:3
<b>font</b> 159:2	21:19	<b>fraudsters</b>	<b>G</b> 4:1	126:9 170:4
<b>Foods</b> 21:5	<b>four</b> 45:3 48:24	107:20 139:23	<b>Gallagher</b>	<b>given</b> 29:4 30:15
<b>footnote</b> 166:13	48:25 125:15	<b>fraudulent</b>	165:14	36:4 45:12
166:18	128:13 147:8	43:18 119:5	<b>gaps</b> 103:24	54:9 100:16,21
<b>Forbes</b> 15:17	156:13 158:11	120:5,15 139:9	<b>garnering</b> 19:6	101:12 102:16
<b>forbid</b> 33:18	158:15 159:19	139:24 145:23	<b>gas</b> 116:20	165:17
<b>force</b> 87:25	165:22	<b>free</b> 40:24 96:17	<b>gate</b> 55:14	<b>gives</b> 106:13
150:7,20 154:5	<b>four-month-d...</b>	97:1 108:13	122:11	167:20
154:9,23 156:8	98:15	137:1,2	<b>gatekeeper</b>	<b>giving</b> 84:1
<b>forceful</b> 150:12	<b>Fourteen</b> 23:12	<b>freely</b> 51:23	134:24	170:5
<b>foregoing</b> 173:5	<b>fragmentation</b>	85:17,25	<b>gatekeepers</b>	<b>Glass-Steagall</b>
173:13	73:17 75:2	<b>frequency</b>	135:2	67:14
<b>forget</b> 68:9,22	<b>framework</b>	128:10	<b>gatekeeping</b>	<b>global</b> 67:14
<b>forgive</b> 154:10	22:15 25:6	<b>frequently</b> 34:12	115:23	<b>go</b> 14:5 16:17
<b>form</b> 10:14 54:3	27:6 54:3 84:2	<b>friendly</b> 74:8	<b>gather</b> 80:12	20:11 31:24
144:22 145:13	<b>Francisco</b> 13:20	<b>friends</b> 49:7	124:12	35:8 37:13
<b>formation</b> 8:6	<b>Frankfurt</b> 13:16	131:17	<b>gears</b> 82:6	41:21 45:20
11:8 16:6,12	<b>frankly</b> 17:10	<b>front</b> 62:5,20,24	<b>Genentech</b> 18:6	57:18 58:4,23
69:4 70:9,22	27:4 35:2	66:4 71:3	<b>general</b> 47:25	60:9 61:6,17
104:16 107:17	39:18 46:8	88:19 125:25	63:23 64:17	61:19 66:9
109:9,11,23	48:14 54:19	<b>front-line</b> 135:2	71:11 99:9	69:20 70:13
136:8 138:9	148:3	<b>front-page</b> 63:7	108:7 142:18	71:24 75:3
150:9 157:2	<b>fraud</b> 4:24 11:5	<b>frontline</b> 122:10	<b>generally</b> 55:21	77:8 82:16
<b>former</b> 82:7	109:18 114:25	<b>frustration</b> 82:8	165:5	88:1 114:12
<b>forms</b> 154:18	115:12 117:16	<b>fuel</b> 155:3	<b>generate</b> 27:20	115:18 123:7
167:7	117:19 118:6,9	<b>full</b> 150:24	65:3	123:21 131:6
<b>Fort</b> 77:20	118:15,19	<b>fully</b> 84:2	<b>generated</b> 33:4	131:13 133:8
<b>forth</b> 10:3 160:3	120:14 126:22	<b>fully-registered</b>	<b>generates</b> 77:5	137:20 138:14



141:19 148:20 154:19 <b>goal</b> 9:16 11:25 12:3,5 105:20 <b>goes</b> 51:11 53:21 63:11 67:3 77:6 87:24 <b>going</b> 11:11,19 12:9 14:6,6 24:10 30:12 31:2 32:23 34:23 41:6 43:12,14 45:17 45:19 47:2,9 47:10 50:1 53:5 54:5,6,10 55:21 57:5 59:7 60:16 62:8,8,11 65:5 66:19 67:21,22 68:20 69:9,15 69:19,20 70:6 70:6,24 71:7,9 71:16,18 74:14 74:17 75:17 76:11,23,25 77:7 82:8,25 83:5,8,17,18 84:17 87:14 89:11,14 91:17 93:19 101:5 104:12,19 105:14 106:19 110:6 114:24 115:1 117:23 121:23 126:8 130:9,10 136:23 137:20 137:21,24 138:18 140:24 142:19 147:2 148:15,23 152:15,18 153:3 159:22 162:25 166:3 <b>Goldman</b> 91:4,5 <b>Gomez</b> 2:10 4:4 6:20 86:8,10 144:15 145:2	149:10 154:4 154:13,17 157:9,12 <b>good</b> 7:5 14:8 20:12 58:21 68:25 73:8 77:19 90:23,23 92:23 94:12 100:9,16 106:11 108:7,8 110:17 115:22 122:16 124:9 130:6,22 131:6 131:17 132:13 136:13 138:5 145:8 148:8,9 155:21 161:2 <b>Google</b> 72:25 <b>gotten</b> 6:22 78:1 <b>governance</b> 47:12 <b>governed</b> 30:17 <b>grade</b> 163:1 <b>Graham</b> 2:3 3:4 4:2,5 7:2 9:20 12:11 35:12 36:8,13 44:2,8 44:11,14 47:4 47:11 52:1,19 52:22,25 53:3 65:22 73:3 74:24 77:12 79:23 80:21 86:9 88:8,16 89:3,6 90:1 91:19,23 94:16 105:22,24 106:20 107:1,9 114:22 136:5 138:12,22 140:9,12 146:1 146:4,6 147:1 148:3,10 149:4 151:3,13,21 152:1 153:5,14 153:17 154:2 154:21 155:20 156:21 157:5,7 158:5,16 159:1	159:13,17,21 160:8,14,23,25 161:2,9,13,16 161:24 163:2,8 163:13,18 165:1,6 166:10 166:19,23 168:5,7,10,18 168:22,24 169:1,5,7,9,18 171:2,4 <b>Grandma</b> 107:23 <b>granular</b> 98:2 98:11,21 <b>grapple</b> 47:18 <b>grateful</b> 7:9,9 <b>gratitude</b> 14:14 <b>great</b> 20:1 24:20 27:8 41:10 50:12 52:16 57:14 70:9 87:19,22 114:14 120:21 125:11 128:10 133:9 138:3 139:22 150:13 <b>greater</b> 35:13,16 41:6 57:1,1 82:5 135:19 <b>greatest</b> 164:21 <b>greatly</b> 57:11 109:20 <b>Gregory</b> 2:20 <b>ground</b> 29:5 126:23 137:3 <b>group</b> 7:14 10:2 26:14 68:10 74:18 79:6,20 95:17,25 96:15 96:20 97:9,9 97:10,12 99:18 100:14,15,21 101:10 102:1,5 102:7,9,16,21 117:25 140:23 152:23 153:11 162:2 <b>groups</b> 24:9	69:25 96:3 99:18,25 100:12,19 101:1,19 102:2 102:4 <b>grow</b> 8:14 12:4 20:17,22 21:7 22:5 74:18 <b>growing</b> 61:21 118:15 <b>grown</b> 20:25 <b>grown-up</b> 81:17 <b>growth</b> 9:17 12:2 14:25 16:5 17:24 18:2,4,7 20:14 20:21 27:2 74:17 <b>guarantees</b> 22:6 <b>guess</b> 4:3 31:7 39:3 42:20 90:5 103:8 105:22 106:21 121:5 125:5 138:21,24 169:12 <b>guessing</b> 36:8 88:22 <b>guidance</b> 34:17 41:22,24 42:19 57:1 148:7 150:2,21 151:5 151:12,22 152:4 155:17 157:25 158:21 161:11,19 162:14 <b>guidelines</b> 34:5 38:9 43:23 51:13 86:18 <b>guiding</b> 18:17 <b>gummed</b> 82:6 <b>gut-level</b> 108:21 <b>guys</b> 38:17 42:18 72:23 76:15 123:12 149:23	<b>Hahn</b> 2:11 <b>hair</b> 38:17 162:21 <b>half</b> 23:14 63:19 64:5 95:24,24 95:25 97:4 <b>hall</b> 9:12 <b>Hambrecht</b> 13:19,21 14:12 14:23 15:15 16:10,18 17:20 17:20 18:12 19:10,13 21:22 22:1,13 28:20 28:25 29:19 31:14,21 39:13 45:14 47:18 55:8 84:13 91:7 <b>Hambrecht's</b> 15:14,21 17:19 18:16 21:8 25:9 28:17 <b>hand</b> 107:10 109:7,7 121:17 <b>handle</b> 70:21 82:25 121:17 <b>handled</b> 49:22 <b>Hanks</b> 2:4 12:16 57:18 58:5 60:1 70:16 75:21 81:11 82:11,14 107:12 114:7 114:10 143:15 148:15 150:3 151:7,11,16,19 151:24 153:19 153:21 157:18 159:15 161:7 161:21 167:12 <b>happen</b> 32:9 151:9 <b>happened</b> 44:4 54:14 60:12 126:14 127:13 <b>happening</b> 129:7 130:16 137:3
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<b>happens</b> 15:17 64:6 138:4	173:6	<b>highest</b> 114:4	<b>house</b> 67:1,2	<b>immaterial</b> 75:12
<b>happy</b> 15:6 50:2 70:14 136:4 140:16 165:19	<b>help</b> 4:25 8:12 8:13 11:4 12:21 13:1,7 14:4,18 17:18 18:22 22:16 51:13 69:8 91:8 107:15,23 121:12 133:6 135:3,23 137:18 164:5	<b>highlight</b> 36:17 117:12 133:23	<b>hovering</b> 119:18	<b>immediacy</b> 101:15
<b>harbor</b> 145:3	<b>helpful</b> 17:14 41:18,21 42:5 44:19 73:23 75:22 94:17 130:4 147:7 170:8	<b>highlighted</b> 102:15	<b>huge</b> 77:8 101:11	<b>immediate</b> 156:25
<b>hard</b> 9:18 60:14 65:3,6 72:4 74:9 79:12 104:15 124:11 129:2 136:17 136:24 137:8,8	<b>helping</b> 7:7 14:16 72:5	<b>highlighting</b> 133:10	<b>Hundley</b> 173:4	<b>immediately</b> 92:25
<b>harder</b> 139:16	<b>helps</b> 16:7 96:24	<b>highlights</b> 133:5 136:3	<b>hundred</b> 112:10	<b>immunity</b> 121:21
<b>harmed</b> 112:24 113:2	<b>heritage</b> 16:11 16:18 17:20	<b>highly</b> 27:15 37:17 42:1 56:2 58:24 61:17 69:16	<b>hungry</b> 35:3	<b>impact</b> 11:15 62:13 75:24,25 95:5 97:14 101:14 135:19 167:13
<b>hat</b> 41:20	<b>hesitancy</b> 81:5	<b>highly-educated</b> 121:3	<b>hurdle</b> 45:9	<b>impacted</b> 65:5
<b>hate</b> 160:5	<b>hesitant</b> 55:4	<b>Hill</b> 150:19	<b>husband's</b> 13:11	<b>impacts</b> 97:22
<b>havoc</b> 67:21	<b>hesitate</b> 166:25	<b>hindsight</b> 40:1	<b>hybrid</b> 93:25	<b>impairment</b> 119:6
<b>head</b> 6:20 13:9 13:19 89:17,24 91:18	<b>hesitation</b> 30:19 43:7 54:9	<b>Hinman</b> 6:2	<b>Hyperion</b> 29:20 33:11,22	<b>impediment</b> 90:12
<b>heading</b> 13:24 170:3	<b>heterogeneity</b> 100:16	<b>hinted</b> 124:11	<b>hyperlink</b> 159:11,22	<b>impeding</b> 67:24
<b>headquartered</b> 13:20	<b>Hey</b> 157:23	<b>historical</b> 84:20	<b>hypothesis</b> 104:8,11	<b>imperative</b> 58:9 150:19
<b>heads</b> 169:25	<b>hi</b> 5:15	<b>historically</b> 74:19 162:7	<hr/> <b>I</b> <hr/>	<b>implement</b> 98:20
<b>health</b> 83:23	<b>high</b> 33:6 34:13 37:16 54:7 57:5 67:9 72:2 76:7 77:7,17 111:8 112:9 118:23,24 126:6 133:15 133:17 134:11	<b>history</b> 20:11 48:18 49:17 111:17 145:16 154:11 155:12	<b>idea</b> 18:17 19:22 24:1 70:19 83:13 106:16 155:13	<b>implemented</b> 95:16
<b>healthy</b> 10:4 12:3 65:10	<b>heterogeneity</b> 100:16	<b>hold</b> 26:24,25 29:14 106:2	<b>ideal</b> 149:2	<b>implementing</b> 9:15 125:18
<b>hear</b> 4:11 5:14 13:3 19:19 29:16 34:11 57:21 62:6 156:20	<b>high-end</b> 37:2	<b>holders</b> 27:25 163:25	<b>ideas</b> 10:3 21:23 133:14 155:21 170:5	<b>impolite</b> 153:9
<b>heard</b> 55:17 86:13 109:4 130:15 154:22	<b>high-level</b> 59:5	<b>holdings</b> 54:7	<b>identical</b> 30:18 54:6 85:12	<b>importance</b> 8:18 109:14 112:24 113:3 115:22 146:16
<b>hearing</b> 4:18 7:1 8:16 12:8 142:19 172:14	<b>high-priced</b> 101:19	<b>hole</b> 49:21	<b>identified</b> 17:21 17:22 40:7 49:12	<b>important</b> 7:14 7:19,23 8:24 14:5,20 24:18 25:11,21 26:3 29:9 36:16 38:16 45:23 53:12 64:13 73:6 74:25 80:10 88:4 94:15 100:3 108:19 115:20 140:6 147:19 150:20,25 151:2 165:23
<b>hearken</b> 150:7	<b>higher</b> 46:7 58:3 92:18,19 101:9 101:15,20 102:20	<b>holistic</b> 11:23	<b>identifying</b> 104:24	
<b>heart</b> 104:2	<b>highly-priced</b> 100:10	<b>home</b> 8:1 13:11 55:25 62:2 131:4	<b>identical</b> 30:18 54:6 85:12	
<b>heavy</b> 105:17		<b>homes</b> 36:7	<b>ignominy</b> 70:10	
<b>hedge</b> 25:25		<b>homogeneous</b> 40:6	<b>illegitimate</b> 139:17	
<b>height</b> 111:19 113:7		<b>honestly</b> 15:6	<b>illiquid</b> 42:2 79:18	
<b>heightened</b> 141:11		<b>honored</b> 5:6	<b>illiquidity</b> 164:23 165:5	
<b>held</b> 25:5 172:11		<b>hope</b> 20:5,7 22:8 44:19 106:17 131:9 165:16	<b>illogical</b> 91:9	
		<b>hopefully</b> 15:8 36:17 75:12 94:4 170:9	<b>illustrate</b> 133:7	
		<b>hopes</b> 37:16	<b>imagine</b> 29:2 52:19 66:17 120:9	
		<b>hostile</b> 37:23	<b>imitators</b> 84:14	

<b>importantly</b> 7:24 8:11 9:5 17:5 77:3 121:25	<b>increasing</b> 9:16 97:14,22 122:16 143:9	115:24 116:10 122:6	53:22,23 54:21 55:2 58:19 64:11 78:6,9 78:10 85:3 87:17 94:13	<b>interesting</b> 13:3 19:6,25 20:23 23:18 30:8,14 41:1 46:3 59:19,24 65:19 71:11 102:25 129:5
<b>imposed</b> 46:7	<b>increasingly</b> 71:22,23	<b>informally</b> 111:14	<b>institutional-t...</b> 49:10	<b>Interestingly</b> 27:24
<b>impossible</b> 122:9	<b>incredibly</b> 6:21 8:2 28:10	<b>information</b> 42:16 64:10 67:25 91:11 98:3,11 102:13 102:19 110:11 110:21 121:7,9 123:19 126:24 127:8 143:23 145:19 164:5 166:7,7	<b>Institutionals</b> 84:9	<b>interference</b> 94:23
<b>improve</b> 15:10 83:9 111:4 167:18	<b>increment</b> 96:4 96:9,11,18,22 96:23,24 97:15 97:18,23	<b>informed</b> 121:24	<b>institutions</b> 16:3 30:20 46:22,24 50:25 52:9,13 54:2,13,16 55:19 70:19 75:14,25 78:17 87:1 88:14 92:2 93:20	<b>interim</b> 107:2 151:5,11
<b>improved</b> 126:18	<b>incrementally</b> 96:4 157:3	<b>informing</b> 132:1	<b>instrumental</b> 14:15 153:12	<b>interject</b> 151:7
<b>improvement</b> 96:13,17 97:2 97:6	<b>increments</b> 11:15 96:7,14 96:16 97:4	<b>infusion</b> 11:2	<b>insurance</b> 141:5 141:12	<b>intermarket</b> 102:10
<b>improvements</b> 70:12	<b>independent</b> 25:22 26:4 30:7 33:11,20 41:14 45:21	<b>initial</b> 11:2,14 16:8 19:18 46:11 92:9 94:3	<b>insurmountable</b> 93:22	<b>intermediaries</b> 10:17 11:10 146:11 157:1
<b>imprudent</b> 35:8	<b>index</b> 63:9	<b>initially</b> 10:22 21:7	<b>integrity</b> 109:15	<b>intermediary</b> 91:7 92:6,18 156:25
<b>inability</b> 80:25	<b>indicate</b> 101:15	<b>innovation</b> 5:19 8:14 16:12 21:22 138:3,5	<b>Intel</b> 21:5	<b>intermediate</b> 160:12
<b>inappropriate</b> 25:2	<b>indicated</b> 167:4 173:6	<b>innovative</b> 138:2	<b>intend</b> 105:10	<b>internal</b> 30:11 122:5
<b>incentives</b> 10:16 97:13	<b>indicates</b> 165:17	<b>Innovator's</b> 21:20	<b>intended</b> 37:11 165:20 166:2	<b>Internet</b> 40:14 117:10 128:24 128:24 129:15 129:17 134:3 134:13,16 135:12
<b>incentivized</b> 58:24	<b>indication</b> 144:19	<b>input</b> 92:4	<b>intent</b> 98:9	<b>interpretation</b> 160:21
<b>include</b> 25:25 41:9 50:3 111:1,13 135:1 140:25 141:20 143:24 156:4 167:10	<b>indications</b> 93:11	<b>insertion</b> 147:6	<b>intention</b> 32:6 46:6	<b>interpretations</b> 124:13 147:11
<b>included</b> 15:8 92:6 108:6 110:25 135:8 150:10 167:8	<b>indicator</b> 142:19	<b>inside</b> 100:14	<b>intentionally</b> 53:19	<b>interpretive</b> 147:24
<b>includes</b> 10:14 24:14 95:18 98:3 110:1	<b>individual</b> 16:3 25:23 35:1,2 54:12 64:11 87:17 117:23 133:24 134:1 137:22	<b>insight</b> 4:13 6:15 15:9 82:5	<b>interest</b> 14:25 22:23 27:1 30:24 36:5 55:9 56:20 70:1 99:14 119:2 127:10 133:15,17	<b>interrupt</b> 114:7
<b>including</b> 6:7 8:10 9:2 13:24 24:4 38:14 91:7 93:7 159:7 160:3	<b>individuals</b> 26:17 109:14 111:15 115:25 116:7,9 118:17 127:15,18,19 128:2,3 129:12 142:1 145:22	<b>insightful</b> 59:6	<b>interested</b> 4:16 16:12,13 19:19 24:17 26:19,23 27:20 37:19 40:17,20 45:5 47:1 48:6 58:12 81:2 104:22,24 159:6	<b>intimate</b> 39:19
<b>inconsistent</b> 148:4 156:23	<b>industries</b> 21:25	<b>insights</b> 8:21 11:14 14:12	<b>introduction</b> 98:7	<b>introduce</b> 5:16 5:24 13:8
<b>increase</b> 22:4,8 114:2,5 121:8 131:16	<b>industry</b> 32:19 65:13 66:9,10 67:18 87:20 102:25 103:13 103:25 115:23	<b>instance</b> 95:5	<b>introductions</b> 156:17	<b>inverted</b> 102:3
<b>increased</b> 75:3 102:10 119:22		<b>instances</b> 52:4 114:25		
		<b>Institute</b> 118:16		
		<b>institution's</b> 75:9		
		<b>institutional</b> 25:1,17 30:6,9 30:24 42:8 45:21 46:18 49:13 50:6,15 50:18 52:6		

<b>invest</b> 10:24 22:4 51:7 79:10 134:13 139:8,19,20	12:6 18:23,25 25:14,17 50:15 53:22 64:7 80:22 88:20 94:4,5,10,13 109:13,22 118:16 125:23 136:2,9,25 137:24 138:8 139:7 140:24	<b>invests</b> 85:13 94:6 <b>invited</b> 147:21 <b>involve</b> 113:15 124:25 129:14 <b>involved</b> 18:12 21:22 43:17,18 57:4 89:21 119:15,17 120:5 123:17 125:10 129:20 170:7	<b>issued</b> 124:3 <b>issuer</b> 19:24 29:4 43:10 58:18 69:15 144:22 <b>issuer's</b> 66:13 <b>issuers</b> 20:8 56:4 69:16 70:7 76:3 <b>issues</b> 10:7 36:18 42:7 54:18 64:13 65:11 80:24,24 95:1 103:7 104:20 106:9 116:4 118:14 126:20 128:18 134:21 143:8 144:14 157:1	133:2 <b>Julie</b> 2:8 6:22,23 16:8 154:2 169:18 <b>July</b> 60:3 157:22 <b>jump</b> 108:13 <b>junior</b> 60:4 <b>jurisdiction</b> 132:16,17 133:1 135:13 143:18 165:25 <b>jurisdictional</b> 144:13 <b>jurisdictions</b> 95:9 110:1,4 110:18 116:5 116:15 135:22
<b>investigated</b> 126:10	<b>investor's</b> 50:6	<b>involvement</b> 34:13	<b>issues</b> 10:7 36:18 42:7 54:18 64:13 65:11 80:24,24 95:1 103:7 104:20 106:9 116:4 118:14 126:20 128:18 134:21 143:8 144:14 157:1	<hr/> <b>K</b> <hr/>
<b>investigates</b> 122:4	<b>investors</b> 8:13 10:8,19,24 11:17 12:4,6 16:2,4,22 19:8 19:24 20:8 24:25 25:1,18 25:23 26:4,7 26:18,24 27:21 27:21 28:3,10 28:11,15 35:5 35:25 36:1,5 36:10 37:6 41:6 42:1,8 49:5,13 50:18 51:2,7 52:6,18 53:23 55:2 56:6,10 58:17 59:3 62:21 64:11 66:4,22 66:23 67:25 68:19 69:3,7 74:2 75:7 76:11 80:18 81:1,7 85:8,13 86:3 89:1 90:24 94:2,11 107:20 108:2 109:7 112:21 112:23 113:9 113:17,25 114:6,12,13,16 114:17 116:13 128:8 129:10 133:16 135:8 135:17 137:5 137:11 140:4 140:19 146:12 156:18 164:6	<b>IPO</b> 13:5 15:22 19:12 20:11 21:4 29:22 58:15,17 60:13 60:20,21 62:18 63:4 64:1 65:10 66:17 71:1,20 72:10 82:18 86:13,17 86:22 88:24 89:20,25 90:11 91:2	<b>it'll</b> 170:19 <b>items</b> 10:14 39:17 63:5 <b>iterate</b> 44:22 <b>iteration</b> 107:13 146:13 170:1	<hr/> <b>Kara</b> 2:6 <b>keep</b> 14:19 38:24 110:21 114:13 124:17 127:11 128:14 137:2 140:1 143:18 146:19 162:17,24 <b>keeps</b> 124:23 <b>key</b> 5:3 18:21 104:18 151:2 164:8 <b>keys</b> 38:16 <b>kicked</b> 147:5 <b>kidding</b> 162:24 <b>kind</b> 12:12 37:7 38:18 39:1 41:19,23 59:5 64:22 66:25 72:18 73:12,12 74:5 76:14,20 82:23,24 88:18 88:22 92:1 106:4,15,21 126:11 136:17 142:12,18,18 148:17,23 152:16,20 155:2,8,13 159:18 160:12
<b>investigation</b> 122:5 126:16 126:17		<b>IPOs</b> 4:7 15:23 15:24 19:20 58:11 60:16,20 61:2 63:15 69:11 71:12 74:17,18 81:17 86:12 95:3	<hr/> <b>J</b> <hr/>	
<b>investigations</b> 111:10,11,12 111:19,21 113:20 115:4 115:11 119:15 127:23 130:14		<b>irrespective</b> 72:11	<b>J</b> 3:9 <b>jail</b> 132:19,20 133:19 <b>James</b> 78:13 <b>Jay</b> 2:5 3:5 5:8 9:24,25 <b>jet-lagged</b> 136:6 <b>Jewish</b> 118:6,7 <b>job</b> 6:2 8:14 24:20 115:22 <b>JOBS</b> 62:2 63:21 65:12 70:9 <b>Joe</b> 5:15,15,17 5:20 7:6 <b>joining</b> 13:21 <b>Jon</b> 173:4 <b>Joseph</b> 2:16 <b>Journal</b> 63:8 <b>judgement</b> 119:6 <b>judiciously</b>	
<b>investing</b> 27:1 40:17 51:8 84:25 131:25 140:3 141:2		<b>isolation</b> 106:6		
<b>investment</b> 5:19 10:20 13:9,14 13:20 16:21 19:7 21:13 24:4 26:6,10 27:3 32:16 33:23 35:25 40:25 41:3 49:8 51:3 58:14 66:21 67:3,15 69:18 75:8 76:5 80:11 81:2 107:22 116:20 121:13,18 122:2,10 139:12 141:22 166:8		<b>issuances</b> 10:17 <b>issue</b> 15:18 35:13,16,20 44:12 54:2 70:19 80:3,22 80:23 88:17 92:20 106:9 118:15 119:23 124:14,16,16 146:9,16,19 151:2,6,16,25 153:24,25 154:1 155:17		
<b>investments</b> 22:10 29:13 42:2 49:7 79:19 80:8,9 108:2 119:10				
<b>investor</b> 10:5,21 10:21 11:3,4,9				

161:23	91:10 92:3,14	143:2,6,10,22	76:24 95:18,19	170:1
<b>knee-jerk</b> 47:7	93:3 96:4,7	143:25 144:2,7	99:19,19,24	<b>leaves</b> 88:20
<b>know</b> 6:13,16,21	97:10,13,21	144:10 145:12	100:23 102:18	<b>leaving</b> 140:8
6:21,22,22	100:17 101:4	145:13,16,21	115:15 135:25	<b>led</b> 5:22
7:22 11:18	101:13,20,21	145:23,24	159:2	<b>left</b> 33:22 72:15
12:1 14:16	101:23 102:23	148:21,22	<b>larger-than-n...</b>	<b>left-hand</b> 60:17
17:10 19:4	102:24 103:8	151:20 152:24	78:23	<b>legal</b> 124:14
20:6 23:9,13	103:10,25	152:24 153:2,6	<b>larger-type</b>	131:12 166:6
28:12,14 31:11	105:6,19,25	153:24 154:1,3	65:15	<b>legitimate</b> 84:16
32:5,7 36:20	106:14,18	154:14 155:5	<b>largest</b> 23:22	139:17,21,21
37:5,6 39:7,16	108:22,23,24	155:13,16,17	37:15	139:25 140:5
39:16,18,22	109:5,17,19,25	155:21,25	<b>late</b> 30:24 31:1	<b>Lehman</b> 14:2
41:15 42:4,6,9	110:12,16	156:1 160:8,8	<b>later-stage</b> 53:12	<b>lenders</b> 71:7,9
42:15 43:11,12	111:3,13,25	162:24 165:11	<b>latest</b> 98:21	71:19
43:15,25 44:9	112:14,21	165:24 166:22	<b>laudable</b> 9:16	<b>lending</b> 67:15
44:19,22 45:3	113:2 114:18	167:3,16 168:4	<b>Laughter</b> 37:25	70:7
46:9 48:2,3,14	115:14 117:3,3	<b>knowing</b> 137:11	59:25 82:13	<b>length</b> 155:12
48:18 49:13,15	117:20,24	<b>knowledge</b> 8:21	91:21 94:21	<b>lens</b> 35:19
49:16,18 50:11	118:7,12,16,23	93:3 131:16	105:23 132:22	<b>less-developed</b>
51:14,15,16,19	119:4,19,20	<b>known</b> 87:19	134:9 140:11	19:3
52:1,14,25	120:8,17,21,25	120:14	142:22 151:10	<b>lesson</b> 37:15
53:8,10 54:18	121:2,6,22	<b>knows</b> 6:19	151:18 155:1	41:17
54:19,22,23	123:13,20		158:25 159:3	<b>let's</b> 90:2 146:6
55:16 56:8,18	124:2,5,17,18	<b>L</b>	160:7 162:22	155:23
57:9,19 58:22	124:21 125:8	<b>L</b> 3:8	163:7 169:15	<b>letter</b> 169:25
60:7,19 61:5,6	125:12,13,21	<b>lack</b> 30:10 38:8	171:1	<b>letters</b> 147:10
61:9,10,13	125:22 126:1,2	41:5 86:20	<b>Laura</b> 2:21	148:19 160:22
62:4,7,9,12,18	126:3,5,8,13	119:4	<b>law</b> 9:15 118:22	<b>level</b> 56:11 57:5
63:6,7,22,25	126:15,19,24	<b>lacking</b> 165:4	132:9 147:15	58:3 63:9,12
64:4,8,18 65:8	127:11,11,20	<b>lag</b> 110:12	<b>laws</b> 132:2	67:9 76:7
65:19,23 66:2	128:9,12,17,20	<b>laid</b> 58:2	<b>lawyers</b> 83:14	92:18,19 96:24
66:15,25 67:8	128:21,23,25	<b>landscape</b> 86:15	130:24 131:2,6	111:8 136:11
67:13,20 68:5	128:25 129:9	<b>language</b> 159:23	132:3	137:5 139:1
68:16,18 70:19	129:10 130:3,4	160:12,15	<b>lay</b> 25:11	<b>leveling</b> 97:20
70:24 71:4,8	130:13,18,24	166:11	<b>layering</b> 138:15	<b>levels</b> 63:6
71:12 72:8,10	130:25 131:3	<b>large</b> 16:2,3 21:7	<b>lead</b> 72:15 105:7	140:20
72:15,17 73:14	132:18 133:2,2	23:13 24:25	108:11 157:15	<b>leverage</b> 44:25
73:18 74:6,7	133:9 134:4,6	34:23 40:15	<b>leaders</b> 20:2	61:18 69:17
74:10,25 75:6	134:12,13,20	44:13,16 48:4	<b>leadership</b>	71:3
75:7,8,14,15	135:16,20,24	49:8 50:6,15	146:18	<b>levered</b> 71:5
76:1,14 77:14	136:19,21	70:19 81:17	<b>leaf</b> 145:24	<b>levering</b> 61:21
78:21,25 79:6	137:1,14 138:3	111:6 116:3	<b>leakage</b> 102:13	<b>levity</b> 163:5
79:7,11 82:3,3	138:12,25	127:13	102:19	<b>liability</b> 90:20
82:7 83:6,16	139:3,5,7,7,11	<b>largely</b> 15:15	<b>learned</b> 17:7,8	<b>license</b> 124:1
84:19,20,22,24	139:14,14,19	45:15 55:12	17:16 41:17	<b>licensing</b> 115:21
85:6,6,9,24	139:24,25	85:10	54:23	<b>lieu</b> 148:13
86:2 87:15	140:7 141:5,7	<b>larger</b> 10:14	<b>learning</b> 41:19	<b>life</b> 18:5 19:11
88:5,11,18	141:8,9,23,24	26:1 50:19	48:15	22:6 24:7
89:8,12 90:5	142:3,5,8,8,12	65:16 70:7	<b>leave</b> 66:9 158:2	53:14 58:15

83:23 116:21 134:20 135:10 <b>lifecycle</b> 20:13 <b>lifestyle</b> 133:18 134:15 <b>limit</b> 79:15 167:22 <b>limited</b> 22:20 28:18 52:12 66:5,5,16 85:20 88:11,15 97:2 147:12 160:21 163:24 <b>limiting</b> 149:14 149:17 <b>line</b> 56:21 67:24 106:4 129:4 136:20,21 140:24 <b>lines</b> 92:3 102:14 125:25 <b>liquid</b> 36:7 <b>liquidity</b> 3:19 5:4 10:12,18 11:12,16 34:7 34:12,21,24 35:15,17,22,23 36:3,6 47:5 62:17,24 64:13 64:14 66:1 75:2 85:20 90:4 95:9 97:14,16 163:23,25 <b>Liquidnet</b> 13:24 <b>Lisa</b> 2:18 <b>list</b> 30:4 39:17 40:19 46:6,10 71:25 116:23 117:3,7 118:10 <b>listed</b> 21:2 29:12 30:18 31:18 33:14 46:21 47:8,10 53:20 80:16 83:18 84:4 85:16 <b>listening</b> 65:18 <b>listing</b> 30:15 32:9 33:1	45:12,18 46:2 55:24 83:19 158:14 <b>lit</b> 102:7,17 <b>literary</b> 164:22 <b>literature</b> 118:20 119:20 121:1 <b>little</b> 13:11 16:17 16:19 17:19 18:16 20:2,9 23:4,17 25:9 33:6 35:7 41:23 44:3,3 50:17 53:25 54:16 55:1,3 56:25 57:17 58:1,3 59:18 60:14 70:23 71:13 73:24 74:22 75:23 76:12 88:12 91:16 99:22 101:23 106:8 110:5,12 115:19 118:12 124:11 139:16 140:20 142:21 147:9,18 152:20 165:13 165:15 168:16 <b>live</b> 93:18 149:3 <b>loaning</b> 69:18 <b>local</b> 8:19 131:11,24 135:17 <b>locally</b> 139:19 <b>locate</b> 64:14 <b>located</b> 13:10 126:21 <b>Location</b> 172:6 <b>London</b> 13:16 <b>long</b> 20:25 32:10 39:18 59:24 75:3 152:1 154:14,19 156:5 160:9 <b>long-standing</b> 160:2	<b>long-term</b> 6:18 155:18 <b>longer</b> 86:21 93:15 94:1 <b>longer-term</b> 101:3 <b>longstanding</b> 153:22 <b>look</b> 4:18,25 5:10 6:25 9:7 11:9,20 12:8 32:6 47:9 49:11,12,15 51:21 52:2 58:14 60:12,13 63:13 64:17,21 65:25 68:4,13 68:16 70:2 71:6,17 72:11 76:12 78:25 82:23 95:5 104:11 105:3 107:2 110:7 112:22,22 115:3,8,19 116:11 124:20 125:15,17 127:7 134:19 135:16,18 137:21 138:17 141:14,15 144:8 153:7 157:24 <b>looked</b> 29:22,24 54:4 63:3 64:24 68:8 72:8,14 79:9 111:17 113:5 123:7 143:25 <b>looking</b> 38:18 48:10 54:3 63:15 66:24 74:2 75:4 85:4 111:9 113:5 116:14 125:12 125:14 126:1 126:25 130:9 131:11 132:11 134:20 143:17	144:19,20 165:12 168:20 168:21 <b>looks</b> 61:2 104:9 123:18 <b>loosey-goosey</b> 131:5 <b>lose</b> 107:22 <b>lost</b> 119:11 <b>lot</b> 41:19 43:6 44:20 55:7 56:5 63:23 64:14 66:9 67:3,4,5,9,11 70:10 73:12 75:2,16,22 76:19 78:14 79:4 80:1 85:4 87:6 92:4 93:2 100:11 102:7 102:16,21,24 103:9 105:7 113:12 129:1 130:22 131:2 143:16 147:5 147:24 148:24 153:1 157:21 167:3 <b>lots</b> 29:1 43:20 84:14 <b>love</b> 6:2 42:4 51:7 <b>low</b> 45:9 63:6 <b>lower-priced</b> 100:8 101:18 105:1 <b>lowest</b> 63:9,12 124:18 <b>lunch</b> 107:5 137:2 <b>luncheon</b> 107:6 <b>Luparello's</b> 155:6 <b>Lynch</b> 13:17	89:24 <b>Madoff</b> 118:5 <b>mail</b> 139:4,13 <b>mailed</b> 139:14 <b>main</b> 104:1 108:17 <b>maintain</b> 10:4 69:3 <b>maintaining</b> 10:5 11:9 <b>majority</b> 48:4 164:14 <b>maker</b> 104:18 104:18 <b>maker-taker</b> 102:3 <b>makers</b> 96:12,17 96:25 97:8 101:22 104:19 <b>making</b> 48:1 69:9 83:1 101:21 108:19 108:20 152:18 152:19 <b>male</b> 134:11 <b>males</b> 121:2,3 <b>Malin</b> 3:8 13:18 14:8 31:9,14 31:20 32:4 34:3,11 35:10 35:18 36:12,14 38:1,20 39:3 40:3,9,13 41:8 42:12,15 44:6 44:9,13,16 46:19 47:6,13 48:4,20,24 49:1,3,6,25 51:18,20 52:11 52:21,24 53:2 53:4,7 80:4 81:3,23 83:8 84:8,12 85:10 92:22 <b>managed</b> 142:11 <b>management</b> 39:10 62:22 66:16 74:1 79:11 87:21
<hr/> <b>M</b> <hr/>				
<b>M</b> 2:6 <b>M&amp;A</b> 60:9 61:11 63:1				

<b>managing</b> 13:18	98:3	166:24 172:2	101:11	118:13,13
<b>mandate</b> 25:7	<b>marketers</b> 41:2	173:7	<b>measures</b> 101:14	123:14 129:6
<b>mandatorily</b> 121:18	<b>marketing</b> 30:6	<b>matters</b> 130:19	108:1	134:4 169:19
<b>mandatory</b> 121:16	30:25 32:15,22	166:23	<b>mechanism</b>	<b>mentioning</b>
<b>manner</b> 57:3	32:24 37:1	<b>mature</b> 50:5	16:14 97:5	71:23 164:24
<b>manual</b> 167:9	39:19 45:15	<b>maturity</b> 84:6	<b>median</b> 60:20,23	<b>merit</b> 107:25
168:2	46:20 49:13	<b>mavericks</b> 19:15	<b>medium-sized</b>	<b>Merrill</b> 13:17
<b>Maria</b> 172:8	56:19	20:5	8:11,18	<b>met</b> 7:20 53:20
<b>mark</b> 66:14	<b>marketplace</b>	<b>maximum</b> 23:23	<b>meet</b> 31:3 33:7	86:17
<b>market</b> 3:19	14:18 16:21,24	<b>mean</b> 29:12 34:7	43:24 45:9,13	<b>metrics</b> 66:23
10:12,18,24,25	17:22 20:10	38:16 39:1	45:18 46:2,9	99:8,13
11:1,12,15,22	24:13 25:4	49:23 51:5,15	51:24 53:22	<b>Miami</b> 126:15
11:24 13:23	34:10 43:10	58:17 67:2	94:6	126:22
15:10,22,23	<b>marketplaces</b>	68:18 72:17,23	<b>meeting</b> 1:9 4:7	<b>mic</b> 7:3
17:11,17,25	10:4 77:8	73:11 84:10	9:23 10:2 11:6	<b>Michael</b> 2:14
18:7,23 19:1	<b>markets</b> 3:11	89:2 90:18,18	12:13 37:9	114:7 117:14
19:11 20:6,19	4:10 6:13 12:3	105:24 114:23	47:1 76:22	119:24 122:18
23:16 25:15	12:5,19 13:5	115:4 117:18	79:8 107:13	142:14 165:23
27:14,19 28:20	13:17,19,25	118:5,23	146:15 152:9	<b>mid-cap</b> 72:6
29:21 32:13	15:1,4,12 18:1	120:11,11	162:19,19	<b>mid-sized</b> 12:18
35:19 36:21	18:20 19:5	122:25 124:15	163:24 169:12	13:2
41:22 42:3	21:10,12 22:10	125:12,15	169:19,20,21	<b>midcap</b> 95:18
43:3,13 44:24	40:14 63:17	128:20 129:5	170:12 171:5	<b>middle</b> 50:23
45:16 48:7	65:12 69:4	129:16,17	172:2 173:8	<b>middle-market</b>
50:3 52:14,17	90:9,10 109:8	130:9,15	<b>meetings</b> 12:17	4:9 64:22
54:10,24 58:10	109:15,16,20	131:20,21	53:23 62:4	69:21 70:3
61:3,16 62:18	109:21 116:13	132:7 136:14	86:12	72:11 74:7
62:25 63:4,6	135:17 155:13	136:17 137:8	<b>meets</b> 26:10	76:14
64:25 67:10,13	162:5,13	137:19 138:16	57:17 80:5	<b>midpoint</b> 96:18
68:5,5 70:2,13	163:25 167:5,5	139:18 141:4	<b>member</b> 6:6,8	<b>MiFID</b> 67:17
73:2,18 80:13	167:17,18,20	142:23 145:9	6:18 13:23	75:17,24 76:11
83:2 84:6,16	<b>Marriages</b>	145:12 149:1	<b>members</b> 4:22	<b>Mike</b> 4:20
85:1,2 87:8,10	152:11	149:24 151:19	6:5,14 7:10	108:10 136:5
89:13 92:15,25	<b>mask</b> 139:23	151:24 152:11	14:10 47:15	138:18 143:15
93:12 95:1,5	<b>masking</b> 103:4	152:21 153:6,6	112:17	144:15 146:4
95:20 96:10,12	<b>mass</b> 40:6	153:24 156:6	<b>memorandum</b>	<b>Mike's</b> 4:25
96:17,25 97:8	<b>massive</b> 21:1	156:23 162:25	145:11	<b>mild</b> 119:6
99:2,8,15	27:20 40:21	166:21 167:3	<b>men</b> 7:25	<b>million</b> 20:15
101:14,22	<b>match</b> 84:24	<b>meaning</b> 71:16	<b>mention</b> 80:4	21:4 23:23
104:17,18,19	85:8 88:25	<b>meaningful</b>	118:12 132:14	28:12 30:1,3
112:14 125:22	90:24	28:12,14,15	140:17 142:24	32:25 33:4,25
135:25 155:5	<b>matching</b> 97:16	32:22 33:8	<b>mentioned</b> 8:16	34:23 37:10
163:23 164:6	<b>material</b> 166:7	41:14 53:16	18:13 22:19	45:3,7,18 46:5
165:5	<b>materialize</b>	62:11,13 68:12	42:18 60:2	46:8 50:8,16
<b>market-maker</b>	45:10	68:13 169:23	63:21 65:12	50:19,24 53:18
28:23 98:4,12	<b>materially</b> 70:4	<b>means</b> 101:21	73:11,23 74:22	53:18 59:20,21
<b>market-quality</b>	<b>materials</b> 120:2	127:12 128:14	80:1 81:13	59:21,22 60:21
	131:12	129:7,8 164:4	95:14 99:2	60:23,24 61:3
	<b>matter</b> 49:25	<b>measure</b> 100:16	103:3 104:25	62:10,10 68:6

83:11,25 86:13 86:17 87:3,10 87:12 88:12 95:21 112:18 112:21 113:17 113:25 114:5 133:12 135:8 144:10 <b>min-max</b> 37:10 53:17 <b>mind</b> 37:9 153:15 155:15 162:17,24 <b>mindful</b> 88:18 <b>mine</b> 152:12 <b>mini-IPO</b> 50:5 <b>minimal</b> 49:19 96:7 <b>minimize</b> 43:17 <b>minimum</b> 31:3 32:25 33:4,24 33:25 37:9,10 41:13 45:7,9 45:13 46:2,10 53:20 94:6 95:7 96:9,11 96:18,21,22,23 97:15,18 <b>minimum-ma...</b> 32:25 <b>Minnesota</b> 135:8 <b>minuscule</b> 124:7 <b>minute</b> 113:5 <b>minutes</b> 38:24 169:11 <b>mirrors</b> 97:5 <b>misconception</b> 24:12 <b>misconceptions</b> 25:4,5 <b>miscreants</b> 166:3 <b>missed</b> 136:6 <b>missing</b> 56:16 111:3 <b>mission</b> 8:7 69:1 69:2 109:6 <b>mistakes</b> 83:1	<b>mitigate</b> 43:16 <b>model</b> 59:12 69:17,24,24 71:2 74:23 75:20 121:15 121:15 125:17 <b>modeled</b> 96:8 <b>mom-and-pop</b> 25:25 <b>moment</b> 81:16 163:5 169:19 <b>money</b> 4:9 20:13 23:1 27:22 28:7 32:24 40:8 45:13,17 46:11 69:9,9 69:10,18 70:7 75:13 76:10 87:22 89:4,7 89:15 91:13 94:6,8 101:22 107:21,22 112:23 113:9 113:12 122:8 129:21 135:13 135:14 137:19 137:23 139:22 <b>monies</b> 133:15 <b>monitor</b> 138:4 140:1 <b>monitoring</b> 99:5 101:7 139:1 <b>months</b> 53:10,15 95:16 98:1,6,8 105:13,16,17 131:21 148:22 149:2 162:16 <b>Morgan</b> 76:2 <b>morning</b> 4:6 5:13,22 7:5 14:8 16:17 73:17 <b>mosaic</b> 10:14 <b>motion</b> 163:14 169:2 <b>Motors</b> 23:15,21 27:11 <b>Mott</b> 2:12 48:17 48:23,25 49:2	49:4,11 51:11 51:19 84:17 119:24 120:7 128:16 129:15 129:19,24 163:17 169:4 170:14,19,21 170:24 <b>mouth</b> 35:7 <b>move</b> 12:13 41:3 94:17 100:24 142:11 145:16 161:22 <b>moved</b> 123:20 163:16 169:3 <b>movement</b> 64:18 96:1 152:15 <b>moving</b> 34:8 96:2 142:7,7,8 <b>multi-jurisdic...</b> 135:20 <b>multi-jurisdic...</b> 135:18 <b>multi-pronged</b> 137:9 <b>multiple</b> 106:9 135:21 <b>Murphy</b> 2:13 6:17 <hr/> <b>N</b> <b>N</b> 3:1,1 4:1 107:8,8,8 <b>N.E</b> 1:25 <b>name</b> 29:19 68:2 72:13,16 172:16 <b>named</b> 5:18 <b>names</b> 71:23 100:14,15 102:8,9 147:5 156:17 <b>narrowed</b> 149:22 <b>NASAA</b> 3:15 11:20 108:4 109:24 112:17 121:11 123:1 125:8 157:15	164:16 <b>NASAA's</b> 4:21 10:11 <b>NASDAQ</b> 13:22 13:23 29:13 30:4,15 31:6 31:17,22 32:9 33:14 34:6 45:12,18,22 46:3,7,10,21 47:1 53:18,20 56:14 82:18 83:19 <b>NASDAQ-listed</b> 45:19 47:2 54:6 55:22 <b>national</b> 8:20 80:16 <b>nationally</b> 131:10 <b>natural</b> 16:11 26:16 104:25 105:4 <b>naturally</b> 105:7 <b>nature</b> 34:15 84:11 123:2 125:23 134:18 <b>navigate</b> 83:14 <b>nay</b> 42:18 <b>near</b> 150:15 151:22 152:2 158:20 161:5 <b>nearly</b> 83:23 100:4 <b>necessarily</b> 6:8 90:12 129:17 143:9 145:14 149:7 <b>necessary</b> 166:8 <b>need</b> 51:13 52:5 63:12 80:6 90:4,6 104:21 159:21 167:14 <b>needed</b> 63:3 70:12 86:18 101:5 103:6 140:20 <b>needs</b> 41:25 <b>negotiate</b> 86:4	<b>negotiated</b> 86:2 <b>nest</b> 107:24 <b>net</b> 25:24 <b>network</b> 25:22 30:7 33:11 41:14 42:9 46:23 51:2 <b>never</b> 24:5 31:2 31:4 33:24 46:2,11,16 66:19 132:8 165:10 <b>new</b> 5:7,16 6:4 7:3,21 9:24 13:21 14:12 15:18 16:13 17:21 22:15 27:8 29:5 35:20 66:4 73:18 82:23 83:19 104:20 109:20 133:16 134:2 142:4,5 146:17,18 150:24 162:23 <b>news</b> 45:1 <b>NewsBeat</b> 44:24 47:24 <b>nice</b> 123:3,10 169:13 <b>nickel</b> 96:2,3,4,7 96:16,23 97:23 100:6,9,11 105:2 <b>no-action</b> 147:9 148:19 160:22 <b>nominate</b> 7:18 <b>non-NASDAQ</b> 34:8 <b>non-NASDA...</b> 35:9 <b>non-traded</b> 116:18,19 <b>normal</b> 104:13 111:2 112:13 112:14,14 133:25 <b>normally</b> 51:16 <b>north</b> 3:14 60:24
--	--	--	--	---



<b>Northwest</b> 59:19	<b>NYC</b> 29:13	33:4,14,23	173:19	85:18 152:9
<b>notable</b> 99:17	<b>NYSE</b> 33:14	34:1,24 35:19	<b>officially</b> 83:14	164:4
<b>notch</b> 97:20	34:8 56:14	37:8,10,14	<b>oh</b> 5:15 76:1	<b>online</b> 134:19
<b>note</b> 99:11 101:9		39:11,15,21	83:12 122:23	<b>open</b> 15:21
166:17 170:2	<b>O</b>	41:10 42:22	122:25 123:6	19:12 26:6
<b>noted</b> 10:20 92:5	<b>O</b> 3:1 4:1 107:8	43:2,17,18	160:23 166:14	51:3 77:20
<b>notes</b> 133:14	107:8,8	44:24 45:5,24	168:20 170:19	106:16 111:12
<b>noting</b> 164:25	<b>obligation</b> 21:11	46:5 47:10	<b>oil</b> 116:20	111:20
<b>notwithstandi...</b>	24:22	49:16 50:14,19	<b>okay</b> 4:2,5 5:12	<b>opening</b> 3:3
148:7	<b>observations</b>	50:24 51:22	7:2 22:11	64:20 118:13
<b>now-large</b> 18:4	99:10	52:23 53:8,18	31:17 32:4	<b>operate</b> 132:2
<b>number</b> 12:16	<b>observe</b> 99:19	54:8,12,16	36:13 39:23	165:10,11,13
23:13 31:3	<b>observed</b> 99:4	55:9,12,15	40:11 44:18	165:18
37:12 52:4	<b>observers</b>	56:6 59:14,20	49:2,4 68:25	<b>operating</b> 13:4
58:12,13 60:7	100:25	65:17 83:25	72:9,14 74:14	<b>operations</b>
60:16 63:19,20	<b>obtain</b> 107:15	84:3 85:15	80:21 91:23	13:14 133:25
64:3 69:7,12	114:4	86:5 93:1,25	107:1 123:24	<b>opinion</b> 54:15
69:13 70:8	<b>obtained</b> 112:18	129:21 134:14	129:19 146:1	94:5
82:4 86:12	132:19,21	139:4,9,17,20	147:1 148:3	<b>opportunities</b>
99:2 102:12	133:18	139:24 144:19	150:24 151:13	4:8,14 8:10,13
103:17 111:9	<b>obvious</b> 27:10	145:17 164:3	151:20 152:14	9:17 11:8
111:10,19	<b>obviously</b> 18:9	<b>offerings</b> 3:7 9:3	153:14 159:17	17:22 35:4
112:7,20	38:16 40:1,15	10:10 12:14	160:24 161:1,2	51:4
113:10,15,20	60:9,24 63:21	16:1 23:10	161:17 163:8	<b>opportunity</b>
114:3 115:11	77:10	24:20 25:22	163:13,18	7:12 14:13
115:13,15	<b>occasions</b> 15:16	32:18 36:2	165:6 166:10	32:10 36:23
116:6,18,19	150:7	39:19 42:25	166:19 168:5,7	38:4 45:4
117:1,1,4,9	<b>occur</b> 167:21	43:24 44:7	168:24 169:9	46:12 50:22
122:16 131:6	<b>occurred</b> 90:25	47:17 48:9,11	170:13,19	54:14 106:13
132:5,16,18,25	<b>occurs</b> 170:11	48:16 55:18,20	171:2	131:13 139:19
134:12 135:10	<b>October</b> 95:16	57:3 65:16	<b>old</b> 25:24 53:15	139:23
143:6,13 144:4	<b>odds</b> 15:10 22:9	82:19 84:24	76:14 77:16	<b>opposed</b> 30:13
154:3 156:7	<b>Odwalla</b> 21:5	85:14,16,24	79:6 130:23	35:15 44:14
159:4,5,19	<b>offenses</b> 142:16	86:2 90:6,22	136:19	61:23 112:4
160:20 165:22	<b>offer</b> 16:14	117:1,2 128:17	<b>older</b> 125:1	138:15 145:5
166:5 168:17	33:11 96:17	128:23 139:3,3	<b>once</b> 45:18 83:5	148:13 152:18
172:4	97:1,6 158:9	139:11,22	93:20 122:8	161:8 163:21
<b>numbers</b> 12:20	<b>offered</b> 19:13	145:23	161:25 164:17	168:15 169:7
22:21 23:8	30:2 36:23	<b>office</b> 5:19 6:20	<b>one-fourth</b>	<b>opposite</b> 142:12
112:15 113:18	141:17	6:23 77:21	119:16	<b>option</b> 113:13
114:1,13,18,20	<b>offering</b> 4:12	89:15 126:15	<b>one-minute</b> 45:2	<b>option-rate</b>
114:20,21,23	17:3 19:12,16	<b>officer</b> 43:8	<b>one-third</b>	113:16
114:24 115:7	19:18 24:24	<b>officers</b> 33:16	119:14	<b>optionality</b> 84:3
118:23 119:18	25:2,19 26:10	34:15,18	<b>onerous</b> 33:16	<b>options</b> 131:25
120:12 128:1	26:19 27:17,23	<b>offices</b> 13:15,16	62:9 63:24	<b>Oracle</b> 21:5
141:20,23	28:19 29:18,21	13:21 14:13	<b>ones</b> 44:20 95:19	<b>order</b> 28:9 86:19
143:11,18	29:21,25 30:12	26:1,2 42:7	127:22 162:23	98:20
<b>numerous</b>	30:13 31:3,7	61:14 127:2	<b>ongoing</b> 13:2	<b>order-by-order</b>
111:13,13	31:13 32:7,25	<b>official</b> 170:10	30:17 72:3,6	98:2,18

<b>ordered</b> 114:12	127:8	82:9 90:20	62:21 64:12	<b>peers</b> 64:23
<b>orderly</b> 69:3	<b>overlooked</b>	91:3,14 92:7	100:8 103:18	<b>penalties</b> 113:1
<b>orders</b> 96:10	146:20	109:6 125:1,2	104:22 106:15	113:23 114:3,6
97:3,7 102:11	<b>overly</b> 153:10	137:13 157:20	109:20 119:7	<b>penalty</b> 115:7
<b>ordinary</b> 19:18	<b>oversees</b> 13:13	167:15 170:9	126:4 134:20	<b>pending</b> 67:16
20:3	<b>oversight</b> 137:21	<b>partial</b> 62:24	135:14 142:17	155:17 161:18
<b>organization</b>	<b>overview</b> 108:7	<b>PARTICIPANT</b>	<b>parties</b> 26:19,23	<b>penny</b> 95:7 96:2
109:24	<b>owned</b> 59:10	82:16 117:14	40:20 45:5	97:4,23 100:5
<b>organizations</b>	120:4	117:16,18	89:20 159:6	<b>penny-trading</b>
105:14	<b>ownership</b> 59:12	130:17 132:7	166:8	96:9
<b>organized</b> 43:3	<b>owning</b> 75:13	134:7 149:25	<b>partly</b> 34:14	<b>people</b> 9:13,14
43:13	<b>oxygen</b> 71:2	150:5 151:14	93:1	26:5 28:5 29:7
<b>orientation</b>	<b>P</b>	151:20 157:13	<b>partner</b> 42:17	31:11 34:20
152:8	<b>P</b> 4:1	159:4 160:1	85:12 121:13	36:1 40:15,16
<b>original</b> 84:18	<b>p</b> 4:1	163:11	<b>partners</b> 37:12	40:17,22 58:11
87:15 172:12	<b>p.m</b> 171:5	<b>participants</b> 2:1	<b>party</b> 142:5	59:14 64:15
<b>OS-0510</b> 172:4	<b>pace</b> 63:14	11:1 25:14	<b>pass</b> 47:3 91:16	66:12 68:2
<b>OTC</b> 23:16	<b>paced</b> 63:14	37:19 57:2,4	105:6 163:9	71:25 72:23
28:20,23 29:6	<b>page</b> 3:2 18:6	99:3,8,15	<b>passed</b> 112:6	75:22 76:1
29:11 33:1	112:5,6,7,20	<b>participate</b> 9:17	121:14	82:18 91:9
37:11 43:4	112:20 127:9	15:20 30:12	<b>passive</b> 168:16	98:23 99:16
167:17	165:22	33:12,22 37:13	<b>Pat</b> 148:8	112:1 120:9
<b>other's</b> 126:17	<b>pages</b> 59:24	38:4,10 42:19	<b>patented</b> 19:13	124:17,17
<b>outcome</b> 30:3	173:5	47:8 50:20	<b>paternalistic</b>	125:20 127:16
126:17	<b>pain</b> 47:21 81:15	52:14 54:13	140:21	127:21 129:24
<b>outlier</b> 21:6	81:24	<b>participated</b>	<b>path</b> 50:9 89:17	132:1 134:18
<b>outline</b> 16:16	<b>painful</b> 82:12	27:24 55:21	89:23,24,25	142:20 162:25
<b>outlined</b> 5:5	<b>panacea</b> 56:20	<b>participating</b>	158:6	<b>people's</b> 108:24
<b>outreach</b> 27:23	<b>Panera</b> 21:5	27:2 47:2 57:6	<b>pathway</b> 12:4	<b>perceive</b> 83:1
<b>outright</b> 128:11	<b>paper</b> 59:23	<b>participation</b>	55:11	<b>perceived</b> 80:24
129:12,13	114:21 157:22	15:23 28:14,17	<b>patient</b> 106:8,10	<b>percent</b> 27:24
136:17,23	159:11	32:20 37:17	<b>Patrick</b> 2:15	40:8 60:8 61:5
137:7 141:7,18	<b>paragraph</b>	38:6,9 39:25	82:17 146:23	61:7 71:15,16
<b>outset</b> 94:5	147:8 155:5	40:6 51:10	147:2 149:22	71:18,19 72:19
<b>outside</b> 17:24	158:11 164:20	98:4	160:19 164:17	85:5 110:17
19:23 20:2	165:4,7 166:12	<b>particular</b> 9:23	164:18 168:8	116:2 119:18
38:7 88:14	166:15,16,16	10:22 16:25	168:18	119:19 143:4
92:24 133:25	<b>parents</b> 119:25	22:23 25:13	<b>Patrick's</b> 159:19	<b>percentage</b> 72:2
<b>outstanding</b>	120:4	26:20 27:15	168:21	72:18 116:4
21:25	<b>Parratt</b> 5:23,25	43:24 81:2	<b>pattern</b> 128:17	124:6 126:6
<b>over-exaggerate</b>	<b>parse</b> 41:2	93:13 98:12	<b>patterns</b> 128:18	127:13
121:5	<b>part</b> 10:14 11:18	128:18 134:10	<b>Paulsen</b> 172:8	<b>perfect</b> 55:3
<b>over-simplific...</b>	12:13 20:1	164:1	<b>pause</b> 140:6	149:8
140:10	24:23,24,25	<b>particularly</b>	<b>pay</b> 67:22 75:19	<b>performance</b>
<b>over-the-coun...</b>	30:20 32:14	17:23 18:20	75:20 124:8	68:9,22 88:5,6
96:12,16,25	49:8 57:16	21:16 24:25	133:16 163:1	<b>performed</b> 88:3
97:8	64:6 67:10,13	29:10 37:1	<b>payers</b> 76:16	<b>period</b> 60:12,19
<b>overall</b> 42:3 65:8	69:19 74:14	42:5 49:14	<b>paying</b> 75:9 76:9	70:4 93:15
115:18 124:3	76:25 81:5,10	57:2 61:17	<b>payments</b> 77:2	94:1 122:2

134:11	132:23 134:8	134:25 137:1,2	<b>policy</b> 6:20,24	<b>pre-order</b> 28:7
<b>periods</b> 55:16	134:10 136:13	<b>plans</b> 135:20	11:19 148:24	<b>precedent</b> 44:3
<b>permeate</b> 65:15	138:21,24	<b>planted</b> 22:15	<b>polite</b> 152:19	<b>preclude</b> 96:12
<b>permission</b>	140:14 141:3	<b>platforms</b>	153:10 157:14	<b>predictions</b> 22:4
28:22	141:22 142:24	167:24	<b>Ponzi</b> 117:9	<b>predominantly</b>
<b>perpetrating</b>	143:21 145:1,8	<b>play</b> 22:13 28:25	126:13 129:13	71:19 78:8
135:4	146:5	50:25 60:10	129:18 133:10	<b>preemption</b>
<b>perpetrator</b>	<b>piggy-back</b>	144:14	133:13,21,24	164:13
133:20	108:15	<b>playing</b> 96:24	134:2 135:11	<b>prefer</b> 61:22
<b>person</b> 66:22	<b>pilot</b> 3:10 4:16	97:20	<b>portfolio</b> 61:21	<b>preferably</b> 150:4
76:6 82:2	9:3 10:11	<b>plays</b> 60:10	85:5	<b>preliminary</b>
<b>personal</b> 14:14	11:13 94:25	<b>plead</b> 132:8	<b>portion</b> 37:3	11:13 12:13
119:8	95:15,17,17,24	<b>pleading</b> 131:5	61:12	103:15,17
<b>personally</b> 50:21	96:1 97:25	<b>please</b> 14:5 86:9	<b>posed</b> 85:11	<b>prepare</b> 39:21
63:10 70:9	98:1,7,21 99:5	108:13 151:16	123:5	<b>prepared</b> 7:22
<b>personnel</b>	99:14 100:5,7	158:12	<b>posit</b> 138:24	173:13
130:18	100:16 103:2,3	<b>pleased</b> 5:6 7:13	<b>position</b> 7:19	<b>present</b> 35:4
<b>persons</b> 156:15	103:5,6,9	<b>pleasure</b> 108:12	46:25 50:17	88:1 124:5
<b>perspective</b> 58:2	104:2,4,7	146:5	73:25 77:4	<b>presentation</b> 3:8
59:5 62:2,17	105:3,15,20	<b>plenty</b> 167:24	153:2 163:9	3:9,15 15:8
64:9 66:14	106:12 170:15	<b>plopped</b> 40:8	<b>positioned</b> 50:14	68:25
67:5 77:11	170:16,20	<b>plunked</b> 27:21	<b>positions</b> 148:24	<b>presented</b> 4:14
<b>perspectives</b>	<b>pilots</b> 103:8	<b>plus</b> 72:18	<b>positive</b> 50:9,10	<b>preserve</b> 65:9
10:15 12:9	<b>pipeline</b> 22:22	<b>pockets</b> 27:22	63:22 65:13	<b>president</b> 7:17
<b>persuaded</b>	57:14	114:12	69:11	13:9
147:14	<b>Piper</b> 64:23	<b>point</b> 24:1 53:21	<b>possibility</b> 27:7	<b>pressure</b> 74:20
<b>Pete's</b> 21:4	<b>place</b> 11:4 18:2	54:1 56:13,16	<b>possible</b> 93:15	75:16,18
<b>philosophy</b>	34:9 58:6	58:12,13 60:18	<b>post-deal</b> 58:25	<b>pretty</b> 85:2
15:15 32:12	73:13 86:23,25	62:16 64:6	64:4 65:25	111:16,23
<b>physical</b> 43:15	96:21 97:5	72:18 74:12,14	66:2,7 73:6	112:15 113:24
<b>pick</b> 93:17	101:5 102:1	74:25 85:11	<b>postings</b> 134:17	116:3,6,22
140:15 146:7	130:12 136:18	89:18 102:24	<b>potential</b> 11:16	127:5 132:24
<b>picked</b> 68:6	149:8 167:15	103:1,23	12:22 21:24	133:3,13
<b>picking</b> 159:23	<b>placed</b> 73:13	104:16 105:18	26:18 39:15	153:24 156:5
<b>picture</b> 115:18	<b>placement</b> 52:7	106:19 108:15	66:4 68:19	<b>prevalence</b>
<b>pictures</b> 104:9	52:14 91:2,4	111:4 115:17	86:20 97:14,22	119:21
104:10	139:5 145:11	123:11 124:9	102:14 146:12	<b>prevalent</b>
<b>piece</b> 115:20	147:4,7	127:7 132:13	<b>potentially</b>	101:18 109:19
<b>Pieciak</b> 2:14	<b>placements</b>	136:14 138:11	34:23 83:15	118:3 120:12
4:20 108:12	117:5 128:10	140:13 147:10	86:13	142:3
114:9,14 115:3	146:11	148:8 150:14	<b>power</b> 61:15	<b>prevent</b> 107:23
117:15,17,19	<b>places</b> 11:24	151:3 168:13	<b>practice</b> 87:1	135:3 136:16
120:6,11	99:12 132:5	<b>points</b> 56:3	<b>Practices</b> 132:10	<b>preventing</b>
122:21,23,25	<b>placing</b> 54:21	89:14 104:1	<b>practitioners</b>	107:21 137:9
123:6,15 124:9	128:7	105:5 111:3	38:14,23	<b>prevention</b> 4:25
124:15 125:11	<b>plain</b> 151:19	112:16 147:8	<b>pre-2000</b> 60:19	136:12
128:20 129:16	<b>plan</b> 95:15	<b>police</b> 136:24	61:7	<b>prevents</b> 97:16
129:23 130:6	<b>plane</b> 76:21	138:19	<b>pre-marketing</b>	<b>previous</b> 110:8
131:19 132:13	<b>planning</b> 103:20	<b>policies</b> 107:15	93:10	123:16,20

143:24 149:11 149:16 <b>preyed</b> 118:6 140:18 <b>price</b> 30:1 54:12 58:24 92:3,24 93:13,17,18,21 94:14 95:8,22 96:13,17 97:2 97:6,16 <b>price-improved</b> 97:3 <b>priced</b> 88:3 <b>pricing</b> 15:23 19:11 20:7 32:8 87:8 93:9 164:5 <b>pride</b> 15:3 166:20 <b>primarily</b> 78:5 102:25 103:21 <b>primary</b> 10:17 35:19 80:3 167:25 <b>principles</b> 18:17 154:8 <b>printed</b> 59:23 <b>prior</b> 9:9 12:17 13:21 49:5 98:6 105:2 108:5 119:17 146:13 148:11 158:7,14,17 159:23 160:3,4 160:15 <b>priorities</b> 8:8 <b>private</b> 13:23 16:15 17:24 36:2 49:5,8,16 52:7,14,16,23 59:16 60:10 61:10,11,13,13 62:15,16,21 79:2 84:24 85:6,14,15,21 85:24 86:2,3,5 86:21 89:14 91:2,4,12 117:5 131:15	131:17 139:5 145:11 146:11 147:4,6 167:18 <b>private-client</b> 78:22 <b>private-place...</b> 117:2 <b>probably</b> 15:20 36:5 38:1 40:10 54:20 61:10 62:19 76:13,23 79:24 82:1,5 85:20 86:10,23,25 88:12 94:19 105:16 108:18 109:4 111:13 112:1 115:13 117:9 119:23 125:19 126:5 129:8 134:24 136:22 140:24 141:3,18 142:3 144:8,9 145:19 145:20 <b>problem</b> 38:23 93:6 120:3 154:24 155:4 163:24 168:2 <b>problems</b> 38:18 <b>proceeding</b> 173:12 <b>proceedings</b> 172:10 <b>process</b> 7:21,22 7:23 15:19 16:19 19:12,13 19:23 21:9,14 22:8 23:2 29:3 29:5 30:23,25 34:5,19 81:14 81:20 82:4,6,8 83:14 94:24 148:21,23 155:19 <b>processes</b> 22:2 111:2 <b>produced</b> 98:5 <b>produces</b> 45:1	<b>producing</b> 51:23 <b>product</b> 26:8 35:3 40:14 65:21,24 69:10 82:24 119:5 <b>productive</b> 95:4 <b>products</b> 40:16 40:18,23,23 91:9 116:15,18 116:19,21,22 117:1,13 128:7 129:9 <b>professional</b> 25:18 94:4,10 <b>professionals</b> 13:15 85:3 <b>profitability</b> 79:14 98:4 104:18 <b>profitable</b> 86:19 <b>profiting</b> 104:3 <b>profits</b> 37:4 <b>program</b> 3:10 137:11 <b>programs</b> 116:20 128:25 137:18,20 <b>progressed</b> 94:25 <b>prohibition</b> 140:25 141:4 <b>promise</b> 55:10 <b>promissory</b> 133:14 <b>promote</b> 72:5 <b>promoting</b> 131:24 <b>promulgation</b> 158:1 <b>Proofreader's</b> 172:1,16 <b>proposals</b> 150:18 <b>proposed</b> 65:16 <b>proprietary</b> 48:3 52:17 123:2 <b>prosecution</b> 130:4,21 <b>prospective</b>	156:17 <b>prospectus</b> 59:23 <b>protect</b> 10:19 11:4 69:2,7 79:17 136:2 <b>protecting</b> 107:20 109:7 116:12,13 119:2,12 140:21 <b>protection</b> 109:13,22 118:16 136:9 138:8 140:24 <b>protections</b> 10:5 11:9 107:23 <b>protective</b> 121:19 <b>prove</b> 84:15 <b>proved</b> 37:17 46:13 <b>provide</b> 8:13 9:5 10:10 11:13 12:3 15:9 33:20 43:20 57:1 67:4 72:3 79:1 108:10 126:24 136:24 150:1 151:22 151:23 152:4 157:25 161:10 161:19 166:7 <b>provided</b> 34:17 123:19 126:23 164:17 <b>provides</b> 121:21 139:23 155:18 <b>providing</b> 24:20 44:14 64:10,13 71:8,9 72:1 120:2 156:17 164:2 <b>provinces</b> 110:2 <b>public</b> 4:10 5:7 7:13,15 9:10 12:19 15:1,12 15:19,20 17:12 18:1,7,20 19:5	19:18 21:10,12 21:13,25 22:10 22:17,25 25:19 47:17 51:22 55:12,24 58:16 60:8 61:18,24 62:8,9 64:5 65:11 66:19 70:13 74:1 89:11 92:15 93:3 99:6 103:16 105:19 111:6 134:22 <b>publicly</b> 91:11 98:9,9 103:23 105:9,10,15 139:6 <b>publicly-avail...</b> 99:4 <b>publicly-traded</b> 59:13 <b>published</b> 23:6 <b>publishes</b> 108:4 <b>pulling-through</b> 92:10 <b>purchase</b> 40:12 40:22 <b>purchased</b> 78:1 <b>purchasing</b> 30:21 <b>purely</b> 46:13 <b>purported</b> 128:23 <b>pursue</b> 19:23 20:4 24:21 27:18 33:17 34:1 46:12 50:12 64:1 67:12 79:16 83:18 130:18 <b>pursued</b> 31:4 53:17 <b>pursuing</b> 14:25 16:13 22:23 34:19 46:17 55:9 61:16,16 80:10 120:8 <b>pushed</b> 152:10 <b>pushes</b> 97:20
--	--	--	--	---

<b>pushing</b> 153:12	145:9 149:11	23:24 28:11	<b>realized</b> 55:12	164:9 167:11
<b>put</b> 17:8 20:18	149:13 152:7	41:13 45:10,13	<b>really</b> 6:10,14	<b>reasonable</b>
21:17 28:7	157:20,23	46:2 50:16,23	14:17 15:23	48:13,14 55:16
35:6 41:22,25	160:11,18	83:24 91:13	21:21 22:11	<b>reasons</b> 12:18
58:1,19 68:1,2	166:11	92:21 137:19	28:4,18 29:1	120:20 141:25
70:1 73:13,25	<b>questions</b> 16:8	139:22	30:25 31:1	<b>recall</b> 148:4
75:16,17 87:16	32:2 42:12	<b>raised</b> 20:12	32:6 33:22	149:5
88:19 99:3	57:20 68:17	21:3,6 33:9	40:7 41:18	<b>recap</b> 55:6
107:21 110:11	70:15 77:12	45:17 70:18	43:17 46:24	<b>received</b> 31:21
110:13 112:25	79:14 86:24	102:13 154:14	50:14,19 53:15	129:22 156:16
122:11 123:12	91:24 103:12	<b>raising</b> 24:13	55:18,25 63:4	<b>receives</b> 11:2
124:2 125:12	106:11,24	28:15 30:2	64:5,21 74:5	<b>receptive</b> 52:20
131:8 147:18	108:13,14	72:25 83:11	74:17 75:16,22	<b>receptivity</b>
152:23 158:10	110:20,23	129:21 137:22	77:4 79:12,17	93:12
158:13 163:5	123:5,8 124:19	<b>rampant</b> 69:13	80:18 86:6	<b>recess</b> 107:6
163:11 166:6	124:22 125:3	109:19	89:22 90:19	<b>recession</b> 111:20
169:25 170:10	136:4 146:2	<b>ran</b> 60:5	92:23 94:25	111:25 113:8
<b>Putnams</b> 76:17	<b>quick</b> 122:18	<b>range</b> 25:24 30:1	95:18 96:1,3,6	<b>recognition</b> 9:10
<b>putting</b> 41:20	<b>quickly</b> 5:21	36:5 68:8	96:8 97:13	36:25 43:9,22
61:21	59:8	<b>rank</b> 96:11	99:24 102:24	<b>recognize</b> 7:10
<b>pyramid</b> 25:16	<b>Quist</b> 17:20	<b>rate</b> 61:20	103:6,23 104:1	<b>recognized</b>
26:12	<b>quite</b> 17:8,10	110:16,17	104:5,13,15	156:8
	27:4 35:2	113:13 133:15	105:7,17	<b>recognizing</b>
<b>Q</b>	39:18 46:7	<b>Raymond</b> 78:13	109:22 110:17	73:15 105:25
<b>qualification</b>	48:14 54:19	<b>re-adopting</b>	112:22 113:8	<b>recommend</b>
17:3 31:4,22	96:8 98:2	149:16,21	118:24 124:11	42:4 81:6
54:11 93:9	100:17,22	<b>re-circulate</b>	124:16 128:24	<b>recommendati...</b>
<b>qualified</b> 23:14	120:8 130:4	162:2	130:24 134:7	4:17 57:9
93:16,17	<b>quorum</b> 4:3	<b>reach</b> 11:7 33:25	139:22 147:17	146:14,17
<b>qualify</b> 82:19	<b>quote</b> 15:14,17	40:16 81:1	165:10,15,20	147:17 148:5
87:9	16:7 28:22	<b>reached</b> 16:25	166:17,24	148:12,13
<b>quality</b> 35:25	37:11 96:15	31:2	<b>Realtor</b> 67:1	149:12,14,16
91:7 95:1,5	97:18 100:24	<b>reacting</b> 33:7	<b>Reardon</b> 2:15	149:19,21,24
<b>quarter</b> 23:8	<b>quoted</b> 18:14	<b>reaction</b> 47:7	31:6,10,17	150:20 156:1
<b>quarterly</b> 59:15	23:16 28:20	<b>read</b> 60:14	37:22 38:11,21	158:7,17,18
<b>question</b> 12:21	31:22 43:3,13	152:13,20	77:14,16,20,23	160:4,15,16
37:23 38:12	<b>quoting</b> 96:7,23	156:5,20	78:3,5,10,12	163:9,14,22
39:23,24,25	<b>QX</b> 23:16 28:20	<b>readers</b> 45:1,16	78:20 79:21	165:8,16,20
48:3,11 49:11	28:23 29:7,11	<b>reading</b> 165:8	141:20 147:4	166:12,17
51:12,12 62:17	33:1 37:11	<b>ready</b> 164:8	154:20,25	167:1,2,8,14
65:23 66:14	43:4	170:22,24	157:17 158:9	167:16 168:3
77:5 79:24		<b>real</b> 32:16,17,18	159:25 162:21	168:13,17
82:2,17,21	<b>R</b>	56:24 73:5	163:4 164:20	<b>recommendati...</b>
84:19 85:12	<b>R</b> 4:1 107:8	93:12 119:2	165:3,7 166:14	3:18 5:3 8:25
86:8 88:4	<b>R.W</b> 64:23	128:25	166:20 168:3,6	9:8 10:12
89:22,23 93:21	<b>radar</b> 127:21	<b>real-life</b> 39:2	<b>reason</b> 33:12	17:13,14 56:23
114:14 122:19	<b>raise</b> 4:9 9:1	<b>real-world</b> 22:3	65:1,3 70:5	56:24 146:7
124:25 125:11	10:23 20:15	<b>realize</b> 53:4	85:23 90:20	148:2 150:6,8
143:15 144:15	21:2 23:11,22	144:16	92:7 147:22	154:6 156:13

158:14 160:4 162:6 169:23 <b>recommended</b> 149:18 159:10 159:10 <b>recommending</b> 149:18 152:2,3 <b>reconvene</b> 107:5 <b>record</b> 172:11 <b>record-keeping</b> 128:6 <b>recorded</b> 173:12 <b>recording</b> 172:14 <b>recurring</b> 12:25 <b>redraft</b> 163:10 <b>reduce</b> 125:8 <b>reduced</b> 62:4 66:13 <b>reducing</b> 50:13 <b>refer</b> 144:11 <b>reference</b> 123:11 124:2 148:11 158:18 160:5 161:11 <b>referencing</b> 157:18 <b>referrals</b> 143:25 144:3,14 <b>referred</b> 144:20 <b>reflect</b> 6:7 29:24 <b>reflected</b> 19:12 149:9 <b>reflects</b> 23:7 <b>Reg</b> 13:5 14:16 14:21 15:1 16:1,9 18:13 21:17 22:12,17 23:15,23 24:2 24:10,13,16,20 24:24 25:2,6 27:14 29:18,20 29:23 30:10,13 30:21 32:12 42:9,22 43:4 43:10,20 50:3 50:12 54:1,8 55:3,9,23 56:13 57:10	65:17 68:3,5,8 68:9,14 70:10 78:19 80:1 81:21 82:19 83:10 84:2,15 91:2 92:1 93:7 130:12 164:7 <b>regard</b> 5:1 90:6 100:13 <b>regarding</b> 34:11 112:2 157:1 <b>regardless</b> 85:17 95:8,8 136:18 <b>regards</b> 11:12 <b>regime</b> 132:1 136:18 <b>regimes</b> 140:2 <b>regional</b> 126:15 127:2,3 <b>registered</b> 29:24 43:5 68:4,15 84:2 116:3,4 127:16,17,22 128:2,5 133:24 141:23 142:16 142:20 143:12 <b>registration</b> 116:1,1 156:18 <b>registrations</b> 116:8 <b>regular</b> 25:24 26:24 <b>regulate</b> 135:17 137:8 141:4 <b>regulation</b> 4:24 27:8 109:18 121:12 122:6 136:11,15 139:15 140:7 141:10 146:11 156:15 157:1 164:3 <b>regulations</b> 14:16 63:24 65:15 67:8,11 73:11,13 136:19 138:15 138:17 140:25 141:6	<b>regulator</b> 108:1 108:22 113:4 <b>regulators</b> 29:4 98:8 109:25 111:14 112:18 113:8,14 116:11 119:1 119:11 120:18 121:8 122:7 127:3 132:17 132:25 137:10 145:20 <b>regulators'</b> 165:25 <b>regulatory</b> 22:15 25:6 27:6 54:3 62:1,7 63:20 80:23 81:12 84:2 109:6 118:22 145:24 147:22 151:23 161:10 <b>reiterate</b> 140:22 <b>reiterated</b> 146:15 <b>reiterating</b> 146:17 148:13 <b>REITs</b> 116:18 116:19 <b>relate</b> 59:7 <b>related</b> 80:25 117:13 <b>relates</b> 88:4 <b>relating</b> 4:24 80:24 134:3 <b>relationship</b> 78:24 79:17 127:5,5 <b>relationships</b> 87:23 88:18 <b>relative</b> 75:12 <b>relatively</b> 14:20 57:25 66:6 71:13 <b>relay</b> 114:17 126:24 <b>release</b> 98:17 102:15 105:10 151:8,17	<b>released</b> 98:15 103:22 105:10 <b>releasing</b> 18:15 <b>relevant</b> 55:19 71:1 <b>reliance</b> 145:12 <b>relief</b> 112:18 116:11 <b>rely</b> 33:19 41:11 93:23 106:13 <b>remain</b> 56:4 70:13 <b>remained</b> 71:13 <b>remaining</b> 95:25 <b>remains</b> 115:23 <b>remark</b> 15:21 <b>remarkably</b> 87:13 <b>remarks</b> 3:3,22 5:14 6:6 7:13 7:15 9:11 15:14 16:16,22 29:10 64:20 70:14 118:14 <b>remedies</b> 131:14 <b>remember</b> 142:6 154:7 164:24 <b>remind</b> 6:6 <b>reminded</b> 132:14 <b>remiss</b> 7:15 <b>repeat</b> 10:25,25 157:17 <b>repeated</b> 153:21 <b>repercussions</b> 121:23 <b>replicated</b> 127:1 <b>report</b> 3:16 4:21 10:11 11:20 23:6 57:12 108:5,6 109:2 109:3 110:3,14 110:15 111:8 114:15 115:6,6 116:14 121:18 123:22 126:12 126:12 133:4 136:4 143:22 143:23 154:5	154:17 159:8 159:16 160:5 162:15 170:10 <b>reported</b> 118:22 <b>reporter</b> 173:4 173:19 <b>REPORTER'S</b> 173:1 <b>reporting</b> 85:18 110:9 121:8,16 123:19 172:13 173:20 <b>reports</b> 111:18 112:6 116:6 123:16,21 143:25 156:11 164:2 <b>represent</b> 9:4 25:23 114:20 <b>representative</b> 15:7 16:24 <b>request</b> 152:19 <b>requests</b> 160:2 <b>require</b> 34:6 96:10 <b>required</b> 32:23 43:5 46:10 93:4 145:5 <b>requirement</b> 97:12 102:6,10 166:6 <b>requirements</b> 85:19 128:6 <b>requires</b> 96:6 97:17 100:23 121:17 <b>research</b> 13:2,13 21:23 31:25 60:2,4,4,5 64:9 64:24 66:1,15 67:22 68:14,21 72:1,10 73:7 73:21,24 74:10 75:24 76:5,9 77:2 95:3 142:25,25 <b>reservation</b> 27:25 40:8 <b>resilient</b> 120:13
---	--	--	---	--

<b>resist</b> 108:25	170:15,18	35:11 36:12	<b>robust-enough</b>	<b>S-1</b> 30:16 54:4
<b>resolved</b> 111:15	<b>retail</b> 30:7 32:16	38:20 40:3,4	13:1	56:15 68:3,7
<b>resource</b> 144:13	33:5,21 36:25	40:12,13 44:8	<b>Rock</b> 13:11	68:14 83:16
<b>resources</b>	42:1 57:4	47:13,25 49:19	<b>role</b> 5:8 7:23	<b>Sachs</b> 91:4,5
144:11	58:19 78:6,15	51:18,21 52:11	11:10 28:24	<b>sad</b> 119:9
<b>respect</b> 35:14	79:20 80:18	52:21 58:6	60:10,10 66:7	<b>safe</b> 43:25 145:3
38:15 41:25	97:3,7 116:13	60:17,25 67:6	66:13	171:4
47:5 69:5	135:17 136:1,2	75:11 81:3,21	<b>roles</b> 71:8	<b>safeguarding</b>
83:17 114:10	<b>retailer</b> 59:18	82:1,24 83:6	<b>rolling</b> 140:7	12:6
144:17 155:22	<b>retirees</b> 78:14	84:10,14 85:8	<b>romance</b> 134:6	<b>safeguards</b> 11:4
<b>respects</b> 51:24	<b>retirement</b>	85:8 88:19,25	134:18	107:16
<b>respond</b> 26:9	107:24 141:2	88:25 90:10	<b>romanced</b>	<b>sale</b> 33:17 64:1
110:19	<b>return</b> 61:20	93:24 107:4	134:12	93:2
<b>responded</b> 27:23	64:8 65:4 75:8	109:23 110:9	<b>room</b> 60:15	<b>sales</b> 57:17
<b>respondent</b>	<b>returned</b> 113:17	122:11 123:9	95:10	59:21 74:9
127:9	113:25	131:20 137:13	<b>roughly</b> 59:21	76:5 77:4
<b>respondents</b>	<b>Returning</b>	137:16 138:8	<b>round</b> 49:21	93:16
127:14 141:24	112:23	138:11,14	146:22	<b>San</b> 13:20
<b>response</b> 32:3	<b>reveal</b> 98:11	150:5,22	<b>rounded</b> 28:11	<b>sanctions</b> 124:1
85:22 86:6	<b>revenue</b> 53:16	152:11 154:24	<b>routed</b> 77:8	124:1
88:16 106:25	<b>revenues</b> 20:19	157:5,19 159:5	<b>rubber</b> 57:17	<b>Sara</b> 2:4 7:6
110:16,17	50:8 53:13	159:17,22	80:5	12:15 90:18
146:3,25	<b>reverse</b> 142:5	167:18,23	<b>rule</b> 18:15 76:15	107:11 108:12
168:25 169:8	144:2	168:18 169:17	148:16 149:8	118:13 152:16
171:3	<b>reverse-engin...</b>	170:22,23	<b>rule-making</b>	<b>Sara's</b> 108:15
<b>responsible</b>	98:20	171:4	148:20,23	111:3
102:20	<b>review</b> 17:6	<b>right-hand</b> 21:2	155:19 158:19	<b>satisfying</b> 145:4
<b>rest</b> 11:3	20:23 23:4,17	<b>rigorous</b> 96:5	162:10,13	<b>savings</b> 135:10
<b>restate</b> 81:4	39:7 55:16	<b>rise</b> 44:4 61:10	<b>rules</b> 14:22	<b>saw</b> 33:10 36:24
<b>restitution</b>	56:7 141:12	<b>risk</b> 3:12 19:17	55:13 131:7	54:11
112:19,21	<b>reviewed</b> 17:2	43:16,17 62:24	147:20 148:8	<b>saying</b> 41:12
113:2,19,23	42:23,25 43:1	79:5 108:3	149:15,17,20	47:21 58:22
114:6,11 115:7	54:5	137:4,5,14	150:1,22 151:5	62:9 63:8 81:5
<b>restricted</b> 97:8	<b>reviewing</b> 54:8	<b>risks</b> 51:8	151:22 152:3	90:8 136:20
<b>restriction</b> 96:19	<b>revised</b> 18:13	<b>road</b> 49:24	155:16,17,23	154:24 156:2
<b>restrictions</b>	<b>revisionist</b>	53:15,22 57:17	156:3 157:24	165:9,10
66:24 96:5,21	145:16	59:3,4 76:21	158:1 161:5,18	<b>says</b> 83:12 96:22
<b>result</b> 7:23 11:17	<b>reviving</b> 6:12	80:6	161:19	118:20 141:10
18:14 79:4	<b>revoked</b> 116:10	<b>roamed</b> 154:20	<b>run</b> 36:16 60:5	150:15 156:24
138:5 165:8	<b>revolutionize</b>	<b>Rob</b> 13:18,23	62:2 137:20	159:6
<b>results</b> 20:7 33:1	15:18	14:6 34:2	<b>run-up</b> 92:25	<b>scam</b> 107:24
59:15 102:25	<b>revolve</b> 16:23	39:24 48:17	<b>runner</b> 72:20	118:19 128:24
103:22 104:23	117:4	57:18 58:2	<b>runners</b> 71:15	<b>scams</b> 117:13
105:18 111:8	<b>rewarded</b> 56:10	65:18 77:13	71:18	121:5
111:11 112:17	<b>rewarding</b> 18:9	79:24 81:13	<b>Russell</b> 87:9	<b>scares</b> 63:10
122:22,23	18:10 19:8	82:22 84:19		<b>schedule</b> 107:3
123:7,10	22:10	90:14 94:17	<b>S</b>	<b>scheduled</b>
124:20 125:3	<b>rewind</b> 53:24	<b>robber</b> 136:20	<b>S</b> 3:1 4:1 107:8,8	169:12,20
125:25 133:3	<b>right</b> 14:7 31:8	<b>Robert</b> 3:8	107:8	<b>scheme</b> 120:14

120:15 126:13 133:10,13,21 133:25 134:2,6 <b>scheme-type</b> 129:18 <b>schemes</b> 116:16 117:8,9 129:13 133:7 134:18 135:11 <b>school</b> 77:17 <b>Schwab</b> 51:6 <b>sciences</b> 83:23 <b>scope</b> 147:12 <b>Scottrades</b> 51:5 <b>screen</b> 21:18 39:14 79:1 <b>screened</b> 40:10 40:11 <b>screening</b> 38:15 <b>screw</b> 19:22 <b>scrutinize</b> 38:6 <b>scrutiny</b> 22:25 34:13 56:11 57:6 81:10 <b>seal</b> 45:23 <b>seasoned</b> 26:17 <b>seat</b> 5:17 <b>Sebastian</b> 2:10 4:3 6:19,21 150:5 154:3 156:2 <b>SEC</b> 4:15 6:5 7:25 9:13 17:2 42:23,25 56:7 57:15 69:2 81:20 83:14 99:5,9 107:25 108:17 113:14 116:12 119:1 119:12 126:14 126:15 127:2,6 137:15 138:2,9 139:2 144:2,5 145:13 146:18 154:18 <b>SEC's</b> 3:11 8:7 <b>second</b> 7:20 25:20 41:20 59:17 61:1	62:1 63:18 81:12 82:11 96:20 112:20 163:17 169:4 <b>secondarily</b> 120:22 <b>secondary</b> 3:18 5:4 10:12,18 11:12,15 28:18 141:12 163:23 163:25 164:6 164:15 167:14 167:15,17 168:1 <b>secondhand</b> 42:16 <b>section</b> 123:18 164:13 168:17 <b>securities</b> 1:1,24 3:14 24:6 26:19 30:21 34:14 36:7 43:19 45:12 49:22 51:23 81:7 93:2,12 95:17,23 113:13,16 132:2,8,12,25 136:22 141:2,5 161:22 164:7 165:4 172:10 <b>security</b> 33:17 43:15 45:20 75:13 85:17,25 131:3,14 <b>see</b> 4:8 6:11 12:20,25 13:5 13:6 14:13 20:21 24:7 28:8 29:10 30:1 37:19 38:3,19 41:1 42:20 55:23,24 56:4,13 59:13 61:4 65:14 69:20 72:4 73:10,19 80:3 86:23,25 92:15 100:25 102:8	103:17 104:21 105:4 108:23 112:5,7,19 113:16 116:16 116:22 117:4 119:14 123:1,4 125:22 127:13 128:4,17,18 129:14 130:2 130:10,13 132:5 133:14 142:4 148:20 149:6 151:9 153:25 155:2 155:23 158:12 159:11 163:10 163:10 168:9 168:13 169:13 170:6 <b>seeing</b> 11:24 33:8 51:10 63:5 71:22,24 92:12,12 99:10 102:7 108:9 134:16,23 153:15 155:15 <b>seek</b> 18:2 25:15 43:1,3 93:8,25 <b>seeking</b> 16:5 23:11 26:6 51:3 <b>seen</b> 18:3 20:10 23:22 32:17 40:20 74:13 83:9 100:7 101:6 104:9 117:13 125:13 128:13 <b>segment</b> 145:22 <b>select</b> 21:11 <b>selection</b> 16:19 21:8,24 22:8 <b>self-directed</b> 51:2 <b>self-marketed</b> 27:16 <b>self-regulatory</b> 105:13 <b>self-sponsored</b>	27:16 <b>sell</b> 45:22 61:23 67:1 79:20 83:1 141:10 164:8 <b>sell-side</b> 66:8 <b>seller's</b> 62:16 <b>selling</b> 40:18 59:22 62:20,25 128:10 <b>semi-annual</b> 164:2 <b>senior</b> 6:23 110:24 118:14 118:14 119:2 119:15,17,22 121:15 125:16 135:6 142:17 143:8 146:18 <b>seniors</b> 111:1 118:14 120:21 121:12 140:17 140:21,25 141:1 143:1,6 <b>sense</b> 55:3,10 67:2 74:15 83:20 85:4 93:13 95:6 105:6 106:3,4 106:5,22 114:22 118:8 120:23 138:22 140:22 148:4 148:11 149:13 149:20 151:4 152:16 159:18 162:2 164:12 <b>sensitive</b> 140:17 <b>sent</b> 144:5 <b>sentence</b> 147:17 147:20,21 164:21,22 165:3 166:15 <b>sentiment</b> 149:9 <b>separate</b> 21:14 76:8 145:25 <b>separately</b> 114:13 <b>September</b>	110:11 115:9 146:14 162:18 169:13,14,17 169:19 <b>sequenced</b> 45:14 46:19 <b>series</b> 52:4,5 64:24 91:3,3 <b>serious</b> 135:5 163:4 <b>seriously</b> 21:11 67:18 <b>serve</b> 26:4,7 28:23 123:17 <b>service</b> 7:12 9:10 <b>services</b> 13:10 14:1 85:13 121:19 134:19 173:20 <b>set</b> 6:11 53:19 54:11 60:7 88:13 103:12 160:3 <b>settlement</b> 67:15 <b>settlements</b> 116:21,21 <b>Seventeen</b> 153:17 <b>severe</b> 135:14 <b>shame</b> 120:23 <b>shapes</b> 63:25 128:22 129:2 <b>share</b> 8:8,21 11:25 12:3,5 14:4 15:6 17:4 28:8 44:20 47:20 66:16 70:2,6 75:10 75:10,10 95:21 <b>shareholder</b> 59:11 <b>shareholders</b> 18:10 59:22 62:20 <b>shares</b> 28:9,20 28:22 29:7 30:2,4 31:4 37:11 46:6,21 64:15 163:25
--	--	--	--	--



164:8 167:6	<b>significantly</b>	13:2 14:24	142:7 165:12	84:15 109:18
<b>sharing</b> 14:11	129:10	16:3 19:19	<b>somewhat</b> 36:22	153:25 167:25
<b>Shelley</b> 5:23 7:7	<b>Silly</b> 170:25	20:12 21:1,7	42:16 63:10	168:1
<b>Shepard</b> 2:16	<b>Similarly</b> 116:7	26:1 28:10,11	115:20,21	<b>span</b> 58:15
5:15,17 94:24	<b>simplistic</b>	37:12 50:24,25	139:24	<b>speak</b> 6:5,13
<b>shift</b> 101:25	138:16	52:7,16,23	<b>soon</b> 84:15	7:12 21:16
128:13	<b>simply</b> 88:25	58:7 59:23	162:21	28:2 35:19
<b>shifted</b> 102:2,4,6	<b>sincere</b> 14:17	63:2 65:2,4	<b>sophisticated</b>	42:17 46:24
<b>ShiftPixy</b> 53:8	<b>single</b> 23:15	70:22 72:6	25:17 94:4,10	127:3 131:14
53:12	27:13 69:14	78:18 87:9,18	120:9	131:20 138:13
<b>Shillman</b> 2:17	79:8 134:12	87:19 89:11,20	<b>sophistication</b>	144:17
99:1	<b>sir</b> 75:5 77:13	90:2,3 95:18	119:4	<b>speaker</b> 83:5
<b>Shimkat</b> 2:18	79:22	123:25 132:25	<b>sorry</b> 60:14	<b>speaking</b> 47:15
<b>shoring</b> 12:6	<b>site</b> 39:9	137:19 150:8	149:10 151:9	94:18 131:10
<b>short</b> 155:18	<b>sits</b> 79:8	154:5,18 156:9	161:4 165:1	<b>speaks</b> 55:1
157:25	<b>situation</b> 145:10	157:2 172:3	166:14 168:20	<b>special</b> 6:23
<b>short-term</b>	<b>situations</b> 22:3	173:8	168:21 170:25	167:5
66:11 101:2	71:22,24	<b>small-cap</b> 58:10	<b>sort</b> 32:19 47:20	<b>specific</b> 23:19
<b>shortage</b> 22:22	<b>six</b> 98:6,7 131:21	58:11 61:6	48:3 50:4 90:7	27:9 34:17
<b>shortcomings</b>	162:16	62:10 64:12,18	91:17 108:20	71:10 110:19
54:25	<b>size</b> 3:10 4:16,17	65:10 69:11,25	109:10 111:9	148:11 150:9
<b>shorthand</b> 50:7	9:3 10:10	72:22 74:18	112:13 114:21	156:2 159:12
<b>shot</b> 20:25 76:6	11:13 33:4	77:6	117:11,20,21	<b>specifically</b>
<b>show</b> 22:3 53:23	36:9 50:18	<b>smaller</b> 4:12	118:1,7,18	149:11
72:2 76:21	60:20,21,23	8:22 10:4,10	120:14 125:12	<b>spectrum</b> 16:3
79:2,6 104:10	61:8 68:8	10:18,22 11:16	126:23 128:12	<b>speculation</b>
124:5 141:24	73:16 75:3	11:22 12:1,18	128:22 129:2,4	102:19
<b>showed</b> 141:23	79:14 88:9	17:23 25:21,25	129:4,11	<b>speculative</b>
143:1	90:11 94:20	37:10 38:24	133:13,20	79:16
<b>shows</b> 4:18	95:3,7,11	47:20 56:17	134:1 138:4	<b>speech</b> 165:14
60:15 111:24	97:18 103:2,7	70:20 76:3,3	141:6 144:13	<b>spending</b> 61:15
<b>shrugged</b> 155:8	104:2,4,6	76:23 79:19	145:15,16	<b>spent</b> 13:22,23
<b>shut</b> 120:13	105:20	88:6,24 90:11	149:25 151:8	87:6,20
<b>side</b> 21:2 22:2	<b>sizeable</b> 90:6	164:1 167:5	165:9	<b>split</b> 95:25
35:2,21 60:2	<b>sizes</b> 4:17 99:19	<b>smart</b> 9:14	<b>sought</b> 23:24	143:16
60:17 66:10	99:20,24 105:5	<b>so-called</b> 113:12	28:19 29:21	<b>spoken</b> 24:15
73:21,21	128:22 129:2	134:5	30:10 44:25	27:12 131:22
109:11 119:10	<b>slid</b> 166:18	<b>social</b> 44:24	<b>sound</b> 152:14,19	<b>sponsor-backed</b>
124:14 136:1	<b>slide</b> 20:18 21:3	47:25 117:25	<b>sounds</b> 47:24	71:1,6
136:15 148:16	<b>slides</b> 58:1 59:8	118:1	80:21 85:19	<b>sponsors</b> 71:2
<b>sides</b> 126:12	70:2	<b>sold</b> 51:1 80:6	90:8 91:14	<b>sponsorship</b>
153:1	<b>slightly</b> 60:23	139:6,6	152:14,20	64:4 66:2,7
<b>signed</b> 31:6	103:11	<b>solely</b> 156:16	168:4	68:21 72:3,6
<b>significant</b> 44:10	<b>slower</b> 29:3	<b>solution</b> 157:4	<b>sources</b> 99:6	73:6
50:8 78:25	<b>small</b> 1:10 3:7	<b>somebody</b> 66:3	<b>south</b> 87:3	<b>spot</b> 59:2,4
104:14 107:19	4:9 5:16 6:19	67:6 69:17	<b>sovereignty</b>	<b>spots</b> 29:1
112:24 113:24	6:20,23 8:11	82:5 101:21	135:23	<b>spreading</b> 85:5
114:2 138:14	8:17,25 9:3	131:13 139:4	<b>space</b> 4:12 6:19	<b>spreads</b> 11:17
144:11	10:8 12:14	141:10,12	13:5 82:19	71:12 74:11

100:1,2,2,7,17 100:23 101:12 101:12,17 102:17 <b>square</b> 49:20 <b>SRO</b> 103:3,5,9 103:18,21 <b>stability</b> 100:19 <b>staff</b> 3:10 4:15 6:5,6,9,14 8:3 135:2 147:11 150:18,23 153:13 160:21 <b>staffer</b> 47:19 <b>stage</b> 11:11 16:25 19:9 48:2,22 60:7 82:23 <b>stages</b> 103:2,15 <b>stake</b> 22:15 <b>stand</b> 23:5 152:17 <b>standard</b> 46:3 47:1 <b>standards</b> 43:11 53:22 <b>standpoint</b> 73:7 73:8 86:15 114:24 <b>stands</b> 23:15,19 80:13 <b>Stanley</b> 76:2 <b>Starbucks</b> 21:4 <b>start</b> 4:6 7:16 <b>start-up</b> 11:2 <b>started</b> 21:1 40:19 42:11 60:2,4 64:4 68:24 69:1 80:2 100:9,10 107:10 126:10 126:10 164:19 <b>starting</b> 6:2,4 13:12 55:14 65:14 113:14 <b>state</b> 13:11 90:9 106:1 108:7,22 109:24 111:14 112:17,22	113:1,3,8,13 114:19 116:11 119:1,11 120:18 121:8 121:18 122:7 124:12,12,12 127:3,4 131:4 131:4,25 132:1 132:17 135:21 137:10 139:1 143:17 144:1 145:20 148:12 153:25 164:9 165:24 <b>state's</b> 130:17 <b>statement</b> 69:1,2 <b>states</b> 1:1 76:20 84:21 108:9,17 109:5 110:13 110:21 111:1,2 115:21 122:15 125:20 126:3 127:4 132:25 135:18,23,24 137:3,15 138:1 143:19 144:18 164:14 <b>stating</b> 153:7 <b>statistic</b> 127:10 <b>statistically</b> 104:13 <b>statistics</b> 23:5,7 98:3 108:6 <b>status</b> 3:19 10:13 162:16 <b>stay</b> 63:18 105:22 132:3 <b>staying</b> 159:20 <b>stays</b> 160:24 <b>Stein</b> 2:6 5:12 5:13 9:21,22 12:12 14:15 18:14 57:24 58:5,14 64:19 <b>stem</b> 9:8 <b>step</b> 58:15 62:18 96:20 166:3 <b>Stephen</b> 2:3 3:4 156:1	<b>Stephens</b> 13:10 13:12 59:8,9,9 59:10,11 60:3 76:13 79:7,7 <b>stepping</b> 19:22 <b>steps</b> 125:8 138:6 146:10 156:14,25 160:12 <b>Steve</b> 5:25 7:6 86:8 90:18 91:3 149:10 155:6 <b>stifle</b> 165:24 <b>stifling</b> 62:7 <b>stigma</b> 120:19 121:8 <b>stock</b> 47:2 62:25 64:8,14 68:9 83:19 87:13 <b>stocks</b> 11:16 58:7,10,23 64:12 69:25 77:6 100:4,8 100:10,17,18 100:21 101:10 101:19,19 102:1 104:7,21 105:1,2,4 106:17 <b>stood</b> 113:22 116:24 117:6 <b>stop</b> 121:9 122:11 160:9 <b>stores</b> 59:20 <b>straight</b> 57:19 <b>strata</b> 73:1 <b>strategy</b> 25:10 <b>Street</b> 1:25 63:8 <b>strengthens</b> 165:16 <b>strike</b> 137:16 <b>strikes</b> 159:13 <b>striking</b> 109:23 137:13 <b>strive</b> 138:7 <b>striving</b> 138:11 <b>strong</b> 11:9 22:23 36:24,25	48:7 63:18 80:17 127:5 133:3 150:16 152:14 155:11 <b>stronger</b> 38:1 105:1 168:13 <b>struck</b> 152:10 <b>structure</b> 29:25 53:17 93:23 96:8,19 <b>structured</b> 29:23 <b>structures</b> 95:24 <b>struggle</b> 125:2 <b>studied</b> 27:11 <b>studies</b> 23:18 25:12 27:9 41:19 44:19 48:9 92:5,6 99:3,18 101:8 102:12 103:1 103:13,14,18 103:20,25 158:14 <b>study</b> 27:12 36:15 53:8 68:1 106:1 143:1 170:15 170:16 <b>studying</b> 103:21 <b>stuff</b> 39:1 67:16 79:2 88:21 91:8 <b>sub-\$200</b> 87:10 <b>sub-\$300</b> 88:12 <b>sub-increment</b> 97:2,6 <b>subject</b> 12:14 56:11 156:18 167:7 <b>submitted</b> 96:10 <b>submitting</b> 105:14 <b>subsequent</b> 93:4 <b>substandard</b> 47:12 <b>substantial</b> 49:8 61:20 82:1 <b>substitute</b> 151:5 <b>succeed</b> 32:18	<b>succeeded</b> 23:25 44:7 <b>succeeding</b> 48:6 48:8 <b>success</b> 15:11 16:4 22:20 27:2,13 28:2 28:13 31:1 33:8 37:20 39:15 45:8 48:5,13 52:16 56:19 88:2 93:4 109:19 147:24 <b>successes</b> 15:5 17:9 84:13 <b>successful</b> 19:4 22:7 31:3 44:23 46:5,17 48:9 72:22 87:4 89:19,20 <b>successfully</b> 18:4 18:8 22:5 <b>succinct</b> 157:23 <b>sucking</b> 70:20 <b>suddenly</b> 107:3 <b>suffered</b> 93:5 <b>sufficient</b> 87:8 159:14 <b>sufficiently</b> 153:7 <b>suggest</b> 69:5 81:19 88:17 161:24 <b>suggested</b> 99:19 158:6 <b>suggesting</b> 35:12 44:2 <b>suggestion</b> 148:9 159:24 <b>Suisse</b> 14:1 <b>suitability</b> 42:1 42:3 128:7 141:8,9 <b>suitable</b> 128:8 <b>summarize</b> 42:20 <b>summer</b> 107:2 169:13
---	---	---	---	--

<b>super-easy</b> 81:18	<b>sweetheart</b> 134:5	110:9 133:8 136:15 145:21 148:22 149:1	119:7,14 126:2 127:7 128:6 133:9,16 134:17 137:7,9 137:12 138:16 150:10 162:25	<b>thing</b> 42:3 76:2 81:5 89:4,7 90:7 96:15 113:22 115:17 116:24 117:5 121:11 129:5 130:9 131:1 133:22 138:25 139:18 142:25 149:13 161:23
<b>super-simple</b> 81:21	<b>swimming</b> 78:16	<b>targeted</b> 33:1 53:18	<b>territorial</b> 126:20	<b>things</b> 17:15 23:19 27:14 32:9 36:9 38:15 43:6,9 43:16 47:15 48:15 54:23 55:7 58:8 60:18 65:5 66:2,12 69:5 70:17 73:16,19 73:22 74:6,21 76:12 79:10,19 81:12 83:4,16 85:3 86:4 88:1 89:12 102:8 120:17 123:25 125:23 126:4 126:25 128:5 130:2 134:17 136:6 137:1,23 142:24 143:16 143:19 149:5 150:10 156:3 156:10 158:3 158:15 167:3 169:24 170:2,5
<b>supervise</b> 128:9 134:1	<b>sword</b> 51:21	<b>targeting</b> 30:15 45:11	<b>territories</b> 110:2	<b>think</b> 4:21 5:24 7:15 10:6,13 11:19,23 12:12 12:17 14:20 15:20 16:10,22 17:8,14,17 19:5 22:13,20 23:6,20 24:7,9 24:18,24 25:11 26:20 27:4,14 28:8 29:9,15 31:12 33:7 34:14,24 35:10
<b>supplement</b> 103:10	<b>sworn</b> 5:8	<b>task</b> 135:22 150:7 154:4,9 154:23 156:8	<b>test</b> 36:23 62:3 96:3,20 97:9,9 97:10,12,22 99:18,24 100:12,14,18 100:21 101:1 101:10,19 102:1,2,21 103:6	
<b>support</b> 10:3,15 15:10 27:18 57:10 59:1 64:9,11 73:7,7 73:20 75:4 92:9,9,15,19 108:1	<b>system</b> 77:3 95:11 131:5	<b>TD</b> 51:5	<b>test-the-waters</b> 93:10	
<b>supported</b> 8:2 80:19	<b>T</b>	<b>team</b> 22:1 79:11 82:18 140:8	<b>testimony</b> 155:7 173:6	
<b>supporting</b> 12:3 109:8	<b>T</b> 3:1,1 107:8 164:3	<b>technology</b> 32:17,19 90:3	<b>testing</b> 104:8,11	
<b>sure</b> 6:16 27:11 42:14 53:1 58:24,25 68:2 79:25 83:12 87:7 97:25 101:6 124:9 139:2 167:8 170:14	<b>table</b> 75:23 156:22	<b>telephone</b> 162:19	<b>tests</b> 96:1	
<b>surprise</b> 52:10 101:11	<b>take</b> 11:23 15:3 21:10 27:10 86:17 103:10 120:1 136:11 138:6 146:9 147:3 148:9 150:12 151:3 152:22 153:8 155:14 156:25 167:6 168:6	<b>telephonic</b> 169:21	<b>testy</b> 152:21	
<b>surprised</b> 53:24 99:16	<b>takeaways</b> 108:18	<b>tell</b> 63:15 77:16 78:1 104:3 115:12,13 129:19	<b>Texas</b> 131:4 133:12,18	
<b>surprises</b> 117:9	<b>taken</b> 23:5 85:11 107:7 116:17 119:2 130:23 153:2 158:20 160:21	<b>teller</b> 136:21	<b>thank</b> 4:12 5:10 5:25 6:25 7:2,5 7:6,6,7,7,11,17 8:3 9:19,20 12:10,11 14:7 14:8 41:17 57:22,23,24 79:21 94:17,22 105:21 107:1 108:10 130:6 146:4	
<b>surprising</b> 100:21	<b>takes</b> 96:20 102:1 117:21 156:14 167:15	<b>teller's</b> 136:21	<b>thank-yous</b> 7:16	
<b>surprisingly</b> 100:1 113:7	<b>talent</b> 66:9	<b>tells</b> 66:6 104:11	<b>thanks</b> 12:16 14:10 27:5 57:18 70:16 82:15 99:1	
<b>survey</b> 110:7,8 110:20 111:5 119:21 122:20 122:24 123:2,8 124:19 125:3 125:21	<b>talk</b> 58:9 66:20 66:20,21 67:1 70:17,23 88:2 99:7 101:23 110:5	<b>tend</b> 76:15 79:1 79:16	<b>theme</b> 12:25	
<b>surveys</b> 111:24 113:6	<b>talked</b> 90:19 91:2 102:14 140:16,18 146:8	<b>tenets</b> 8:6 18:18	<b>themes</b> 107:18	
<b>suspect</b> 122:11	<b>talking</b> 52:3 61:14 67:6 68:11 69:12 72:18 88:21 89:11 90:21,25 92:1 93:24	<b>tenuous</b> 95:4	<b>thesis</b> 65:8	
<b>suspended</b> 116:8		<b>term</b> 21:21 147:6 150:16 152:2 155:18 157:25 158:20 162:17 165:18	<b>they'd</b> 27:12 129:25	
<b>sway</b> 150:13		<b>terms</b> 19:6 20:25 28:13 33:16 34:6 39:14,15 44:23 48:1 50:13 53:13,14 54:21 73:20 79:14 90:4,4,5 94:12 105:12 105:19,25 112:17 113:19 113:23,23 114:6 115:18 116:12,16,19 117:8 118:11		
<b>swear</b> 172:9				
<b>sweep</b> 102:10				

35:18 36:12,15 38:2,9,13,17 38:22 39:4,14 40:13,20,25 41:4,8,13,15 41:25 42:5,6 42:15,18,22 43:20 44:13,16 44:20,23 47:6 50:7 51:11,20 52:2,11,12,21 53:21,24 54:18 55:6 56:15,23 57:8,15,20 58:9 59:23 63:3,17 64:22 65:13,25 66:1 66:12 67:13 68:12,19 70:11 70:25 73:11,22 73:23 74:3,5 74:16,21,24 75:6,14,18,22 75:25 76:6 80:4,5,9,13 81:3,3,4,14 82:3,21 83:8 83:13,22 84:8 84:12,23,23 85:1,10 86:7 87:19 88:3 89:18 91:14 92:2,12,16,23 93:2,13 94:16 94:19,25 99:16 99:22 101:4 102:23 103:13 104:15,17,19 105:7,15 106:12,12,14 106:17 107:18 107:22 108:18 109:12,21 110:15 111:7 111:25 112:5,5 113:3 114:19 115:3 116:18 116:25 118:3 119:20 121:14	121:20 122:3,9 122:15,25 124:18,21 125:19 127:4,7 129:7,8,13 130:8,21,24 131:17,19 132:3,19 133:6 133:19 134:11 135:2 136:3,13 136:16,22 137:7,9,14,15 138:1,7,9 139:7 140:2,5 141:6,14,18,22 142:2 143:3,9 144:2,12 145:9 145:10,19,25 146:21,22 147:10 148:7,8 149:8 150:20 151:1,4 152:1 152:13 153:6,9 153:10 155:3 155:11,20 157:13,20,21 159:21 160:1,5 160:23 163:2 164:16,24 165:23 166:6 166:23 167:1,2 167:13 168:12 169:18,25 170:11,17,23 <b>thinking</b> 66:23 67:21 68:25 84:18 85:23 87:6 91:25 92:4,7 145:14 169:24 170:24 <b>third</b> 7:24 23:8 62:15 165:7 <b>thirsty</b> 26:8 <b>thought</b> 13:3 15:13 32:18 41:5 59:6 62:8 91:17 95:2,3 95:12 108:8 118:5 129:25	145:18 147:6 164:22 165:11 165:15,17,21 166:15 170:4,5 <b>thoughtful</b> 10:2 150:18 <b>thoughts</b> 9:7 56:22 61:1 108:24 148:1 163:12 <b>three</b> 18:17 48:23 49:12 54:10 59:2,4 63:5 64:3 69:4 70:8 72:12,16 75:10 96:1,3 97:10 102:2,5 102:8,9,16,21 108:17 112:6 112:20 156:19 158:15,24 159:5 165:23 166:5,12,16 168:9,14,17 <b>threshold</b> 104:25 <b>thrilling</b> 47:22 <b>throwing</b> 159:16 <b>Thursday</b> 5:9 <b>tick</b> 3:10 4:16,17 4:17 9:3 10:10 11:13 73:16 75:3 94:20 95:3,7,11,15 98:21 103:2,7 104:2,4,6 105:5,20 113:24 170:15 <b>ticking</b> 39:17 <b>tier</b> 25:20,21 42:24,24 43:4 <b>Tierney</b> 2:19 91:25 153:15 153:18,20,23 155:25 161:18 162:3,9,15 167:20 168:8 168:12,20,23 169:3	<b>tiers</b> 49:12 <b>tilt</b> 109:10 <b>time</b> 20:5,5,16 23:1 27:7,7,13 27:13 29:17 30:23 31:6,20 39:18 40:20,21 47:9 50:13 58:17 59:20 60:12 61:3 62:17 64:24 67:18 70:1,4 73:4 79:12 81:24 83:2,5,7 84:5 87:6,8,10 87:20 93:16 94:18 100:20 103:1 105:18 106:19 107:25 110:12 119:10 122:3 140:23 143:11 149:16 152:12 154:15 155:12 157:14 161:23 164:7 169:22,22 170:9,11 <b>timeframe</b> 130:11 <b>times</b> 19:2 25:1 25:15,18 26:6 34:20 39:9 40:24 52:17 56:1 82:4 86:4 86:12 94:9 111:14 114:16 119:9 131:22 132:3 135:2,11 141:15 143:4 144:7,13 146:8 158:24 <b>timing</b> 105:12 156:12 <b>title</b> 163:6 <b>today</b> 5:17 6:2,5 6:10 7:13 9:2 9:23 11:6 14:4 19:5 20:16 29:6 58:9	59:11 61:19 63:5 65:9,24 66:15 71:17 73:1 96:9 163:9 <b>Today's</b> 10:9 <b>told</b> 106:22 <b>tone</b> 155:4 <b>tool</b> 122:6,10,17 <b>top</b> 25:16 60:13 60:15 75:17 76:15,16 112:25 115:22 116:17,23 117:3,6 118:9 129:4,6 <b>top-line</b> 53:16 <b>topic</b> 4:6 14:5 155:7 <b>topics</b> 9:1 <b>total</b> 115:15 <b>totally</b> 137:6 <b>touch</b> 38:21 50:1 83:6 133:6 <b>touched</b> 55:7 56:25 135:7 <b>tough</b> 74:17 <b>town</b> 9:11 <b>trade</b> 29:8,15 58:25 97:17,19 99:19,20,24 100:23 101:20 132:9 164:10 <b>trade-at</b> 97:11 102:5,9 <b>tradeable</b> 51:24 85:17,25 <b>traded</b> 43:3,13 68:10,10 <b>tradeoffs</b> 22:24 <b>traders</b> 77:4,4,4 <b>trades</b> 29:6 68:22 164:15 <b>trading</b> 3:11 11:15 17:12 28:18 64:11,15 65:4 67:20 68:16,18 73:8 73:21 74:10
---	--	---	--	--

76:5 77:3,5 81:14 95:21 96:11,22,22 97:15,15,18,22 98:12,19 100:5 100:6 101:9,11 101:12,14,15 102:1,7,16,21 104:20 105:2 128:9 142:10 155:13 162:13 166:2 167:5,14 167:15,17,21	<b>travels</b> 171:4 <b>treat</b> 51:17 106:9 <b>treating</b> 106:8 <b>tremendous</b> 20:14 57:6 63:16 92:25 113:9 120:2,8 124:14 147:24 <b>tremendously</b> 126:18 <b>trend</b> 111:24 <b>trending</b> 111:18 111:21 112:9 113:18 115:5 <b>trends</b> 11:21 17:21 60:13 108:6 125:22 133:7 <b>trepidation</b> 20:1 <b>trial</b> 131:6,6 <b>trick</b> 158:23 <b>tried</b> 68:4 93:6 120:18 138:1 141:6 <b>trillions</b> 61:15 <b>true</b> 34:6 61:5 107:12 172:12 173:5 <b>truly</b> 29:5 46:6 <b>Trump</b> 7:17 <b>trust</b> 10:20,21 10:24 18:25 58:14 150:23 163:11 <b>trustworthiness</b> 118:8 <b>try</b> 14:19 25:5 26:14 46:16 51:16 69:8 74:9 84:10 104:4,15,19 108:25 121:6 124:18,24 138:7,9 145:4 <b>trying</b> 16:1 17:16 49:15,20 66:3 73:5 87:16 89:21	91:8 92:21 111:4 120:25 121:12 134:21 136:16 137:16 140:12 150:12 160:9 165:24 170:7 <b>tuned</b> 105:22 <b>turf</b> 126:20 <b>turn</b> 5:21 7:3 12:15 22:9 73:17 98:23,25 111:7 137:11 146:6 <b>turned</b> 87:13 <b>turning</b> 107:24 <b>turns</b> 120:23 <b>tweaking</b> 53:11 <b>two</b> 4:11 5:3 42:10,24 43:4 49:3,14 58:4 58:13 63:20 69:13 70:25 77:25 87:11 97:9,12 102:4 112:7 123:24 136:14 142:24 150:6 164:20 165:4 <b>two-and-a-half</b> 75:9 <b>two-year</b> 95:17 170:20 <b>twos</b> 42:24 <b>tying</b> 67:15 69:13,22,23 70:18 155:21 <b>type</b> 16:14 22:24 29:25 32:11 79:15 116:11 120:13 127:8 128:4 129:13 <b>types</b> 50:4,11 54:23 116:22 117:8 150:10 <b>typical</b> 49:16 92:10,14 <b>typically</b> 29:3 33:15,19 35:20	39:8 41:9 50:6 52:5 71:7 76:21 79:19 83:24 85:13 <hr/> <b>U</b> <hr/> <b>U.S</b> 1:24 13:15 76:17 95:6,11 110:3 172:10 <b>ultimate</b> 62:17 87:15 <b>ultimately</b> 89:24 <b>ultra-high</b> 25:24 <b>unauthorized</b> 128:9 <b>uncertainty</b> 152:5 158:22 <b>uncharted</b> 29:2 29:5 <b>uncovered</b> 30:24 <b>under-reported</b> 118:25 <b>under-reporting</b> 120:21 <b>underline</b> 158:24 <b>underlying</b> 122:23 <b>undersigned</b> 172:9 <b>understand</b> 8:17 11:22 18:20 22:24 24:18 34:20 41:2 51:8,14 56:5 73:5 77:21 81:25 83:25 <b>understanding</b> 11:18 30:20 39:20 41:5 42:20 52:8 76:9 106:1 160:17 <b>understands</b> 22:20 <b>understood</b> 32:22 40:7 54:2,5 55:2 106:21	<b>undertake</b> 95:13 <b>undertook</b> 30:5 32:23 <b>underwrite</b> 10:17 <b>underwriter</b> 14:21 27:17 43:1 56:9 94:14 <b>underwriters</b> 39:6 56:12 72:2 <b>underwriters'</b> 39:5 <b>underwriting</b> 3:7 4:11 9:2 10:9 11:11 12:14 13:2 22:14 66:13 71:24 79:8 <b>underwritings</b> 14:21 31:15 39:5 47:8 70:5 78:8 90:15 <b>underwritten</b> 90:22 <b>undoubtedly</b> 10:6 <b>undue</b> 81:10 <b>unfinished</b> 170:3 <b>unfortunate</b> 32:8 <b>unfortunately</b> 30:25 33:24 84:12 <b>unicorns</b> 12:23 19:4 <b>unique</b> 23:20 59:12 76:13 <b>unit</b> 100:20 <b>United</b> 1:1 84:21 <b>unlisted</b> 29:11 29:12 33:13,15 33:17 34:13 <b>unpredictable</b> 37:17 46:1,14 56:2 <b>unregistered</b>
---	--	---	---	---

127:14,15,18 128:3 129:11 129:12,15 130:18 142:17 143:2,3,7,12 145:21,22 <b>unsatisfactory</b> 155:10 <b>unshackle</b> 73:24 <b>unsophisticated</b> 120:10 <b>unsuccessful</b> 46:14 66:6 <b>unsure</b> 70:10 <b>unusual</b> 23:20 27:15 28:24 54:16 95:6 <b>update</b> 3:10 4:15,20 107:2 <b>updates</b> 10:10 164:4 <b>upstream</b> 78:17 <b>upward</b> 113:24 <b>urged</b> 154:8 <b>urging</b> 15:19 146:9 157:14 <b>use</b> 38:2 48:1 50:7 70:21 92:17 102:10 103:9 122:7 124:4 133:2 134:16 168:15 168:19 <b>useful</b> 38:13,22 44:20 73:20 106:5 111:6 148:7 <b>uses</b> 39:13 <b>usual</b> 12:8 116:22 <b>usually</b> 132:18 135:12 <b>utilize</b> 21:14 32:12 <b>utilized</b> 21:23 <b>utilizing</b> 22:7 <b>utmost</b> 109:13 113:3	<b>V</b>	68:8,11,17 72:19 83:16 84:2 107:21 139:17 144:23 <b>vet</b> 18:24 21:12 48:12 <b>vetted</b> 15:4 40:19 85:3 91:10 94:13 <b>vetting</b> 39:14 44:10 <b>viable</b> 67:12 74:10 <b>viatical</b> 116:21 <b>vice</b> 13:9 144:6 <b>victim</b> 118:18 119:16 120:19 120:22,24 121:1,20 122:12 <b>victims</b> 117:21 118:8,11 135:3 135:3 143:2,7 <b>videos</b> 45:2 <b>view</b> 11:23 17:15 19:14,20 25:1,16 28:13 34:4 40:5 41:16 44:9 50:3 51:15 52:22 56:10 75:1 93:12 122:5 145:20 <b>viewed</b> 33:13 78:24 82:4 <b>viewers</b> 45:3 <b>viewing</b> 35:18 <b>viewpoint</b> 109:12 <b>views</b> 6:7,15 7:1 151:1 <b>vigilant</b> 136:25 <b>violations</b> 132:9 <b>Virginia</b> 133:22 <b>virtually</b> 30:16 <b>virtue</b> 43:4 141:1 <b>visit</b> 39:9 <b>VIX</b> 63:9	<b>voice</b> 54:15 <b>volatility</b> 63:7,9 101:1,2,3 <b>volume</b> 68:16,18 77:7 95:21 99:16,17 100:22,23 <b>volumes</b> 102:18 <b>volunteer</b> 7:11 <b>vulnerability</b> 141:16 <b>vulnerable</b> 119:3,12 135:9 143:5	131:8 133:6,8 135:23 146:7 147:2 150:14 151:4 152:17 153:4,8 154:15 154:19 155:15 155:22 156:6 156:20 157:23 158:2,13,19,21 159:7,12 161:5 161:12,13,15 161:21 163:5 163:10,10 165:9 167:22 <b>wanted</b> 28:6 41:20 45:8,8 82:16 87:7 146:19 149:6 152:5 156:11 <b>wanting</b> 144:9 <b>wants</b> 91:5 97:17 <b>warned</b> 46:20 <b>warranted</b> 155:12 <b>Warren</b> 59:11 79:7 <b>Washington</b> 1:25 172:6 173:7 <b>wasn't</b> 21:6 46:6 121:22 <b>waters</b> 62:3 <b>way</b> 17:3 34:7 36:20 37:1 41:8 42:23 48:15 52:2 56:1 63:11 66:11 75:3 76:9 79:9 84:16 86:2 92:21 98:14 104:3 106:12 110:21 111:5 112:25 114:19 122:19 123:19 124:23 130:20 131:15 138:6 138:14 139:22
	<b>W</b>	<b>W.R</b> 13:19 14:23 15:14,21 16:10 17:19,20 18:16 19:10 21:8,22 22:13 25:9 28:17 29:18 31:14,21 39:12 84:13 <b>wait</b> 136:20 149:7 <b>waiting</b> 157:3 158:1 <b>walk</b> 164:18 <b>walking</b> 99:13 <b>walks</b> 58:20 <b>Wall</b> 63:8 <b>wallet</b> 40:25 <b>wallets</b> 27:22 <b>WalMart</b> 59:19 <b>want</b> 5:15 6:16 7:11,17 9:11 9:22,24 15:17 19:21 26:25 31:22 37:23 38:11 41:23 50:16,23 51:21 52:25 58:4,10 65:2,10 66:20 66:20,21,25 81:11 86:22 89:17,23 91:20 97:19 115:17 118:11 119:24		

147:9 150:14	54:23 56:24	<b>widows</b> 130:23	126:2 135:19	142:14,23
163:1 166:3	61:4 72:8,9	<b>William</b> 64:23	135:24 137:16	152:7 153:11
169:21	74:12 77:3	77:14,17	<b>works</b> 27:7 29:6	159:19
<b>ways</b> 55:10	78:21,21,23	<b>willing</b> 19:15,17	37:2 83:12	<b>yea</b> 42:18
56:25 93:7,23	79:9 83:9,22	37:13 56:7,8	<b>world</b> 25:16	<b>yeah</b> 31:20 38:1
97:21 105:4	87:19,19 88:21	56:10 165:19	51:6 76:18	39:3 40:9,13
124:18 167:21	93:6,9 100:7	167:25	81:17 149:2	42:12,14 44:16
<b>we'll</b> 12:13	104:9 107:14	<b>willingness</b> 8:21	<b>worldwide</b> 44:25	48:4,20 49:1
42:24 54:24	107:19 118:13	47:19	45:3	49:25 51:20
57:18,19 71:24	125:13,18	<b>winding</b> 44:18	<b>worse</b> 93:18	52:24 53:2,2
82:14 83:2	127:17 128:13	<b>winning</b> 18:21	119:23	60:9 77:20
84:14 93:25	130:2 131:24	<b>wise</b> 84:7	<b>worth</b> 25:24	78:4 80:4 81:4
107:4 115:8	133:8 138:7	<b>wish</b> 24:21 29:8	67:2 77:21	84:8,12 89:8
127:11 128:12	141:6 146:8	93:14	146:17 164:25	90:13 91:22
128:14 130:10	147:23 150:6	<b>withdraw</b> 168:3	<b>worthwhile</b>	105:12 106:20
162:21 170:10	153:1 159:9	<b>withdrawn</b>	95:12 147:10	114:14,21
<b>we're</b> 5:6 11:24	167:1	23:12 124:3	<b>worthy</b> 12:23	117:19 118:10
15:25 39:17	<b>website</b> 123:22	<b>withdrew</b> 116:1	<b>would-be</b> 108:2	120:6,11 123:6
48:5 50:17	130:2	<b>women</b> 7:25	<b>wouldn't</b> 85:24	124:9 129:16
51:9 53:10	<b>wedding</b> 19:21	134:12	91:12 115:12	129:23 130:6
58:22,23 59:15	<b>Wednesday</b>	<b>wonder</b> 92:16	116:3 127:21	131:19 132:13
60:21 63:5,14	169:16 172:5	<b>wondering</b>	153:15 155:14	132:13 134:8
65:14 69:12	<b>weeds</b> 38:12	44:12 90:1	167:22	136:13 138:21
71:22 73:12	81:12	106:21 136:10	<b>wrapped</b> 76:24	140:14 141:3
74:8 75:4	<b>week</b> 5:9 6:3,4	138:15	<b>wreak</b> 67:21	141:18 142:8
76:20 81:15	9:10	<b>word</b> 21:8	<b>wrestling</b> 136:7	143:21 145:1,8
82:22,24 83:5	<b>welcome</b> 3:3 4:2	<b>wording</b> 38:2	<b>writing</b> 163:12	145:8 146:5
89:10,21 90:21	4:13 5:19 7:6	<b>words</b> 9:11 35:6	<b>written</b> 150:1	147:4 148:6
93:8,24 97:19	9:22,24,24	49:21 78:16	164:22	149:4 150:5
97:25 101:6	<b>Wellingtons</b>	<b>wordsmith</b>	<b>wrote</b> 157:21	151:3 153:18
102:6 103:14	76:17	151:14		154:4 156:5
104:2,22,24	<b>went</b> 40:4 65:18	<b>work</b> 5:5 9:18	<hr/> <b>X</b> <hr/>	157:16 159:5
110:9 125:14	75:15 84:22	15:16 22:16	<b>X</b> 157:24	159:25 160:13
130:9 134:16	111:17 129:21	32:10 37:13,14	<b>XYZ</b> 94:13	160:25 161:13
134:21,23	133:23 165:12	47:20,25 69:19	<hr/> <b>Y</b> <hr/>	161:14,16
135:19 136:7	<b>weren't</b> 128:8	75:11 122:7	<b>Yadley</b> 2:20	162:23 168:22
137:20,21	<b>whatsoever</b>	125:7 126:3,6	34:2,4 35:6	168:22,23
138:25 145:12	148:17	135:18	47:14 90:14,18	170:21,22
145:13 148:15	<b>whirlwind</b> 6:3	<b>workaround</b>	91:22 140:15	<b>year</b> 20:18 23:7
149:1 150:12	<b>wholly</b> 99:10	168:1	148:6 157:20	23:8 50:9 53:9
151:24 152:2,3	<b>widely</b> 25:4	<b>worked</b> 13:17	163:16 169:16	54:1 57:12
152:18,24	<b>widen</b> 100:2,2,8	18:13 53:9	<b>Yamanaka</b> 2:21	59:2,4 60:16
153:7 155:5,21	101:12	77:18 125:18	39:24 40:4,10	60:20,20,22
157:18 163:9	<b>widened</b> 100:1,9	126:14 138:9	41:4,17 42:14	62:10,10 63:13
165:24 169:24	<b>widening</b> 4:17	<b>working</b> 5:11	46:16 82:21	63:14,19 84:21
<b>we've</b> 12:18 18:3	<b>wider</b> 11:14,17	13:6,6 14:1	84:5,9 122:18	108:4 110:7,8
20:10 21:23	101:11 102:17	29:19 57:15,16	122:22,24	111:21,22,22
22:12,19 23:22	105:5	60:25 74:9	123:3,9,24	112:10,10,12
40:20 42:23	<b>widgets</b> 9:13	93:8 125:18	124:10 125:5	112:15,15,19

113:25 114:1,2 114:2 115:10 115:16,25 116:17 117:3,7 119:15,16,19 121:14 123:17 123:21,21 125:9,14 127:12,16,25 129:9,20 132:19 133:22 137:21,22 142:15 143:11 148:5 154:16 157:22 <b>year's</b> 108:5 115:5,6 126:12 126:12 130:11 <b>year-after-year</b> 123:13 <b>year-and-a-half</b> 42:10 <b>year-over-year</b> 123:13,16,23 125:7 127:10 <b>years</b> 4:23 13:22 13:24 18:3 42:10 48:23,24 48:25 59:2,2,4 59:4 60:3,9 63:10 71:14 72:13,16 73:14 87:5 119:17,22 125:1,16 128:13 132:19 132:20 133:19 139:19 142:13 148:19 152:11 152:11,16,21 152:25 153:12 153:17,22 156:7 157:24 159:6,7 <b>yesterday</b> 9:12 14:13 63:8 108:16 <b>yielded</b> 33:24 <b>York</b> 13:21 14:12 83:19	<b>young</b> 53:14 55:5 <b>younger</b> 19:3 <hr/> <b>Z</b> <hr/> <b>zero</b> 58:23 126:19 <hr/> <b>0</b> <hr/> <b>0</b> 68:14 <hr/> <b>1</b> <hr/> <b>1</b> 45:7 68:11 95:20 117:1 118:21,24 144:10 <b>1-A</b> 54:3 <b>1,000</b> 76:19 144:4 <b>1.5</b> 59:21 <b>1:30</b> 107:5,9 <b>10</b> 1:15 37:10 50:16,19 71:14 73:14 85:5 122:15 139:19 142:13 172:5 173:7 <b>10-year</b> 134:11 <b>100</b> 1:25 60:23 60:24 61:3 63:15 76:15 83:23 87:12 116:2 135:8 <b>106,000</b> 68:17 <b>108</b> 3:14 <b>11</b> 105:13 <b>11:48</b> 107:6 <b>12</b> 28:8 116:25 156:7 <b>13</b> 20:15 116:25 123:22 135:7 <b>130</b> 60:22 <b>130-ish</b> 78:22 <b>13th</b> 169:17 <b>14</b> 3:8 119:19 123:22 <b>14.1</b> 113:10 <b>140</b> 23:10,13 <b>146</b> 3:18 <b>15</b> 32:25 33:4,24	50:16,19,23 53:17,18 122:3 156:7 <b>15,000</b> 20:20 <b>15c2-11</b> 28:22 <b>16</b> 126:11 <b>16.7</b> 28:12 <b>169</b> 3:22 <b>17</b> 148:19 152:11,11,15 152:21,25 153:12,22 <b>170</b> 13:15 <b>171</b> 173:5 <b>18</b> 53:15 149:2 164:13 <b>19</b> 133:19 <b>19-D</b> 108:16 <b>1933</b> 59:9 <b>1970</b> 59:17 <b>1986</b> 20:11,15 <b>1988</b> 21:19 <b>1991</b> 13:12 <b>1995</b> 60:16 <b>1A</b> 83:15 <hr/> <b>2</b> <hr/> <b>2</b> 62:9 95:22 117:1 164:3 <b>2,000</b> 112:3,11 112:11 <b>2,400</b> 28:9 95:23 <b>2.2</b> 113:11 <b>2.5</b> 62:10 143:3 143:4 <b>2:55</b> 171:5 <b>20</b> 30:3 50:23 60:9 119:18 122:3 <b>20/20</b> 40:2 <b>200</b> 14:24 28:9 55:8 83:22 <b>2000</b> 87:9 <b>2005</b> 154:4,9,12 154:17,22 155:22 156:8 158:18 159:7,8 <b>2006</b> 110:8 154:18 156:9	157:11 <b>2007</b> 154:7 <b>2008</b> 60:22 61:4 113:14 154:7 <b>2009</b> 111:20 113:9 114:4 <b>2010</b> 112:9 113:10 <b>2011</b> 113:11,15 <b>2012</b> 113:16 <b>2013</b> 4:18 <b>2014</b> 111:17 116:25 165:14 <b>2015</b> 68:7 95:15 108:8 110:9 111:11 113:23 115:19 123:22 126:10 133:5 133:19 135:1 146:15 157:6,7 159:10 <b>2016</b> 3:15 10:11 13:22 20:19 107:14 108:6 110:10 111:8 116:14 130:11 <b>2017</b> 1:15 60:17 110:11 172:5 173:7 <b>211s</b> 81:18 <b>24</b> 59:24 <b>245</b> 114:5 <b>25</b> 30:2 50:8 <b>250</b> 14:24 55:8 83:22 116:9 <b>26</b> 60:3 <b>27</b> 84:21,22 <b>270</b> 68:6 <hr/> <b>3</b> <hr/> <b>3</b> 23:12 95:20 <b>3,000</b> 22:3 115:25 124:2 <b>3,500</b> 112:9 <b>3.1</b> 30:1 <b>3.b.3.0</b> 163:6 <b>30</b> 30:3 34:23 50:8 59:20,21 60:21 61:7	63:10 <b>35</b> 68:6,12 <b>37</b> 133:12 <hr/> <b>4</b> <hr/> <b>4</b> 3:4 <b>4(a)2</b> 144:24 <b>4,800</b> 111:22 <b>4.7</b> 113:10 <b>4.95</b> 59:20,21 <b>40</b> 86:17 <b>400</b> 60:19,20 <b>405</b> 113:25 <b>44</b> 118:21 <b>45</b> 71:15 121:3 <hr/> <b>5</b> <hr/> <b>5</b> 37:10 50:23,23 68:14 85:4 117:6 118:24 129:6 139:19 <b>5,000</b> 111:12,16 111:23 <b>5.8</b> 20:19 <b>50</b> 20:16 21:3 23:23 53:17,23 60:8 61:7 83:11,25 86:13 87:3 <b>500</b> 116:7 144:4 <b>506</b> 117:1,5 128:17,19,20 128:23 129:1,6 129:14,21 139:11 144:18 145:3,12,17,24 <b>506(b)</b> 139:3 144:23 <b>506(c)</b> 139:3 <b>51</b> 109:25 <b>51-jurisdiction</b> 110:16 <b>538</b> 112:21 114:1 <b>55</b> 71:16 121:3 <b>57</b> 3:9 <b>59</b> 20:19 <hr/> <b>6</b> <hr/> <b>6,300</b> 27:21
---	--	---	---	---



**6,500** 111:20  
**6/6/2017** 1:18  
**60** 27:24 40:8  
72:19  
**65** 118:17,24  
125:1 141:11

---

**7**

---

**7** 3:5 13:22  
45:17  
**7,000** 68:17  
**700** 113:17

---

**8**

---

**8** 13:15 95:16  
**8.5** 61:5  
**80/20** 76:15  
**800** 112:18  
**85** 71:17,19

---

**9**

---

**9** 111:18  
**9:04** 1:16  
**90** 72:18 116:2  
**900** 132:20  
**94** 3:10  
**96** 110:17  
**97** 110:17

