UNITED STATES SECURITIES AND EXCHANGE COMMISSION

MEETING OF THE ADVISORY COMMITTEE

ON SMALL AND EMERGING COMPANIES

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

PARTICIPANTS:

Stephen Graham, Chair
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Jay Clayton, Co-Chair
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Lisa Shimkat
Annemarie Tierney
Gregory Yadley
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CO-CHAIR GRAHAM: Okay, welcome, everybody. Sebastian, I guess we have a quorum?

MR. GOMEZ: We do.

CO-CHAIR GRAHAM: Okay. Our business this morning -- we will start with the topic that flows from our last meeting, where we discussed the decline in IPOs, and the fact that we'd like to see more opportunities for small and middle-market companies to raise money in the public markets.

We will hear from two underwriting firms active in the smaller offering space, and we thank them for coming and welcome their insight as to the challenges and opportunities presented.

We will also get an update from SEC staff on the tick size pilot. This committee has been interested in widening tick sizes since our tick size recommendation in 2013. We look forward to hearing what the data shows so far.

This afternoon Mike Pieciak will update us on NASAA's most recent enforcement report. I think it is fair to say that the members of this committee, through the years, have always had a desire for more data relating to the connection between regulation and fraud prevention. We look forward to Mike's help in this

regard.

And finally, we will end this afternoon by finalizing two key recommendations having to do with finders and secondary liquidity.

Before we begin the work I just outlined, let me say that we're very pleased and honored to have with us for one of his first public appearances in his new role, Chairman Jay Clayton. Chairman Clayton was sworn in on Thursday of last week. Congratulations on that. Thank you very much for coming, and we look forward to working with you.

Is Commissioner Stein -- yes. Okay. We also have Commissioner Stein with us this morning. And we will hear remarks from both of you.

And is Joe Shepard? Oh, hi, Joe. We also want to introduce a new face in the Small Business Administration seat today, which is Joe Shepard. He was just recently named as the associate administrator for the office of investment and innovation. So welcome to you, Joe.

And now I will quickly turn to the division of corporation finance. And they are led this morning by Deputy Director Shelley Parratt, who is -- who will introduce the others, I think.

MS. PARRATT: Thank you, Steve. I am back to

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being deputy director, and I am very excited about that. I love that job. Bill Hinman is starting today. It's been a whirlwind week for me with Chairman Clayton and the new division director starting in one week.

I speak for all SEC staff members today when I remind you that any remarks made by any staff member, including me, reflect his or her own views, and not necessarily those of the Commission or any other member of the Commission staff.

I am really excited about your agenda today, and I see that you are well set up to continue your discussion about reviving or facilitating further activity in the markets. I know that I speak for all staff members when I say that we really appreciate your insight and your views.

I want to make sure that you know who else is up here from CorpFin. Betsy Murphy is one of our associate directors, and a long-term member of CorpFin, and knows the small business space very well. Sebastian Gomez is the head of the small business policy office, and I know you all know Sebastian incredibly well. And I know that you've gotten to know Julie Davis very well. Julie is a senior special counsel in the office of small business policy.

Thank you again for coming, and we look forward

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to hearing your views.

CO-CHAIR GRAHAM: Okay, thank you. And now I would like to turn the mic over to our new chairman. So, Chairman Clayton?

CO-CHAIR CLAYTON: Well, good morning, and thank you. Thank you, Steve. Sara, thank you. Welcome, Joe and Shelley. Thank you. Thank you for helping me along so much. I appreciate it.

I am grateful to be here, grateful to the members of the committee. I recognize that this is a volunteer committee, and I want to just thank you for all your service and for the opportunity to speak to you today. I am pleased that my first public remarks as chairman could be to this important group. As these are my first public remarks, I think I'd be remiss if I didn't start with a few thank-yous.

So, first, I want to thank President Trump for having the confidence in me to nominate me for this important position.

Second, to all those I met during the confirmation process -- and it was certainly a new process for me, but I know that I'm better prepared for this important role as a result of that process.

And third, and most importantly, to the dedicated women and men of the SEC who have made me feel

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at home. It's only been a few days, but I feel very comfortable here, and I feel incredibly well supported by my fellow commissioners and by the staff. So thank you for that.

Now, to the business of the day. Facilitating capital formation is one of the central tenets of the SEC's mission, is the focus of this committee, and it is one that I share. One of my priorities for the Commission is to focus on facilitating capital-raising opportunities for all companies, including, and importantly, small and medium-sized businesses. Doing so will not only help those companies, but it will also provide expanded opportunities for investors, help our economy grow, facilitate innovation, and further job creation.

As I mentioned during my confirmation hearing, I do understand the many challenges facing small and medium-sized businesses, as well as the importance of those businesses to our local economies and, collectively, our national economy. I appreciate your willingness to share your knowledge and insights about smaller and emerging companies, and the challenges they face.

This committee has already made important recommendations that facilitated the ability of small and

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emerging companies to raise capital. The topics on your agenda today, including finders, the underwriting of small offerings, and the tick size pilot, among others, represent discussions that we should be having, and, importantly, that I expect will provide a basis for action.

I look forward to your thoughts and any recommendations that stem from your deliberations.

And finally, again, to echo some prior comments, this is Public Service Recognition Week, and I want to close my remarks with a few words from our town hall of yesterday. This agency and this committee is all about the people. There are no widgets here, at the SEC. It's about smart, caring people analyzing and implementing the law in an environment that is ever-changing, with the laudable goal of increasing the opportunities for all to participate in America's growth.

With your hard work, you are ably assisting in that effort. And thank you.

CO-CHAIR GRAHAM: Thank you, Mr. Chairman.

Commissioner Stein?

COMMISSIONER STEIN: I also want to welcome everybody to the meeting today. And, in particular, I want to welcome our new chairman, Jay Clayton. Welcome, Jay.

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This advisory committee is dedicated and a thoughtful group. And at each meeting I found they are bringing forth their best ideas about how to support and maintain healthy marketplaces for smaller companies, while maintaining appropriate investor protections. And, like me, I think you will undoubtedly benefit from the committee's discussions of issues that are critical to both small and emerging companies, and to investors.

Today's agenda will examine the underwriting of smaller offerings, provide updates on the tick size pilot, discuss NASAA's 2016 enforcement report, and consider recommendations on secondary market liquidity and broker-dealer finder status. I think all of these agenda items form part of a larger mosaic, which includes varying perspectives on how best to support access to capital, how to best create economic incentives for intermediaries to either underwrite primary issuances, or to create secondary market liquidity for smaller entities, and how to best protect investors.

It's been noted that investment follows trust. Investor trust and investor confidence are central to the ability of smaller companies, in particular, to initially raise capital and to continue to access is. And when investors trust the market, they invest again. And they repeat their engagement with the market. Such repeat

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engagement benefits all market participants, from the start-up that receives an infusion of initial capital to the investor who can rest assured that there are appropriate investor safeguards in place to help protect them from fraud.

So, in the meeting today I encourage you how to best reach that balance between the creation of capital formation opportunities for companies, while still maintaining strong investor protections. I look forward to your discussions on the role of intermediaries at both the underwriting stage and -- again, I'm going to emphasize in regards to secondary market liquidity -- preliminary data from the tick size pilot may provide all of us with initial insights into the efficacy of wider trading increments, their impact on secondary market liquidity for smaller stocks, and also on the potential cost to investors that may result from wider spreads. This is all part of our, you know, understanding, when we think about policy choices, going forward.

I, as always, look forward to the NASAA report on enforcement efforts and trends. And to effectively examine and understand the market for smaller companies, again, I think we have to take this holistic view of what we're seeing in a variety of places in the market.

We all share the goal of facilitating capital

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access for smaller companies, which, as we know, are the engines of growth for our entire economy. And we all share the goal of supporting healthy markets that provide a pathway for companies to grow and investors to engage in our markets. We also all share the goal of safeguarding investors and shoring up investor confidence.

So, as usual, I look forward to hearing your perspectives on how to best achieve this balance, going forward. Thank you.

CO-CHAIR GRAHAM: Thank you, Commissioner Stein. I think that does it for the kind of the preliminary part of the meeting. And so we'll move on to the subject of underwriting small offerings. And so I turn it over to my co-chair, Sara.

CO-CHAIR HANKS: Thanks. At a number of our prior meetings -- and I think it might be all of them -- we've discussed reasons why smaller and mid-sized companies are not accessing the public markets in the numbers that we'd like to see. We discussed the very complicated question of what we -- can we do to help companies who are not either current or potential billion-dollar unicorns, but nonetheless still worthy of finance.

One recurring theme that we see is there is not

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currently a robust-enough ecosystem to help facilitate underwriting and ongoing research of small and mid-sized companies. We thought it would be interesting to hear from a couple of broker-dealers who are operating in this space, Reg A and IPO markets. What do they see that's working? What do they see that's not working? Where can we help?

First, I would like to introduce Brad Eichler, executive vice president and head of investment banking at Stephens Inc., a financial services firm located in Little Rock, Arkansas, my husband's home state. Brad has been with Stephens since 1991, starting as an associate in the firm's research department. He currently oversees the firm's investment banking operations, which has over 170 professionals, and 8 offices in the U.S., as well as offices in London and Frankfurt. Earlier in his career, Brad worked at Merrill Lynch Capital Markets.

Next to Brad is Rob Malin, managing director and head of equity capital markets at W.R. Hambrecht and Co., an investment bank headquartered in San Francisco, with offices in New York. Prior to joining Hambrecht in 2016 he spent over 7 years with NASDAQ, most recently as founding member of NASDAQ private market. Rob spent five years at Liquidnet, including heading the firm's equity capital markets business. He began his financial services career working for Credit Suisse, Barclays, and Lehman Brothers.

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

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

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

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

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

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

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

But it is equally applicable for what we're

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

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

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

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

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

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

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

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has always advocated that the public markets are an appropriate place to seek growth capital.

And what we've seen over the years is there are many now-large companies who successfully access growth capital early in their life cycles. Some examples on this page: Apple, Adobi, and Genentech, that were able to finance their early growth in the public market, and do that very successfully. And, while that was, obviously, rewarding for those companies, it was also rewarding for their shareholders.

As you all are aware, our founder, Bill Hambrecht, was very involved in the construction of the revised Reg A and worked, as I've mentioned, closely with Commissioner Stein. And, as a result, was quoted throughout the -- releasing the final rule.

So, a little bit further about W.R. Hambrecht's guiding principles. The idea has been to follow three tenets.

First, identify exceptional companies. We understand that, particularly in the public markets, the key to winning financing is to be an exceptional company. We endeavor to identify those companies early, to help them market themselves appropriately to a broad investor community, and to vet them to a degree that ensures that investor trust and comfort with the deals that we bring

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to market.

Certainly these companies are often times younger, less-developed companies than many of the unicorns that are, you know, perhaps most successful in the public markets today. But I think they are no less interesting, no less valid, in terms of garnering investment capital, and certainly can be much more rewarding for the investors that get in at a very early stage.

W.R. Hambrecht has also been focused throughout its life on delivering efficient market pricing. So that's reflected in the offering of the open IPO process, a patented process that Hambrecht has offered many companies. In my view, that's been embraced mostly by mavericks. So those CEOs that are willing to do something dramatically different with their offering have been willing to risk doing something a bit out of the ordinary for an initial public offering.

I was interested to hear a small company CEO say that many view their IPOs like their daughter's wedding. So you want to do everything you can to ensure that you don't screw it up. So the idea of stepping outside of a traditional process to pursue something that you believe has benefit for investors, for the issuer, is interesting and exciting. But the fact is that there is

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a great deal of trepidation on the part of these company leaders to do something a little bit outside of the ordinary.

Nonetheless, we will continue to pursue that, and hope to find those mavericks from time to time. And, you know, by delivering this more efficient market pricing, we hope to deliver better results for both issuers and investors, of course.

So a little bit more about the changes that we've seen in the marketplace. And this feels like ancient history, when you go back to Adobe's IPO in 1986. But it's a good example of a company that raised a small amount of money early in its lifecycle and financed tremendous future growth. So the equivalent -- Adobe's capital raise in 1986 was the equivalent of $13 million today. And at the time they had fewer than 50 employees. So that allowed that company to grow. As of February this year, when we put this slide together, they -- the market cap was over 59 billion, revenues in 2016 of 5.8 billion, and now over 15,000 employees.

So, as you can see, that early growth capital was a critical component in allowing Adobe to grow. And what I found most interesting about our review of what's changed in the past is that Adobe was not alone, by a long shot, in terms of companies that have grown to be

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massive companies that started off with a small capital raise. So I've listed on the right-hand side of the slide here several companies that raised less than 50 million in their IPO -- Starbucks, AOL, Pete's Coffee, Whole Foods, Panera Bread, Odwalla, Intel, Amgen, Oracle, and Cisco. So this wasn't an outlier, in that it raised a small amount of capital initially to grow very large.

So just a word about W.R. Hambrecht's selection process for companies that we believe should be financed in the public markets. We take this very, very seriously. We believe it's our obligation to select and vet these companies and bring them to the public markets as companies that are deserving of public investment dollars. We utilize a data-driven process. So, separate and apart from all of our traditional analyses of these companies that we speak to and engage, particularly in discussions about Reg A+, we will put through what we call a disruption screen.

So, since its founding in 1988, Clayton Christensen, the author of "The Innovator's Dilemma," and, really, the coiner of the term "disruptive innovation," has been involved with W.R. Hambrecht, and we've utilized his ideas and his research to drive our selection of companies that we believe have the potential to disrupt industries and be outstanding public companies. Bill Hambrecht and his team, on the venture capital side of our firm, have applied these processes in many situations. We show here over 3,000 real-world predictions to increase the chances that they will invest in companies that grow successfully.

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

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

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

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

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

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

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

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

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

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

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

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

The second tier, and what we believe is the critically important tier for some of these smaller offerings is that network of independent broker-dealers. Those broker-dealers represent individual investors that perhaps range from ultra-high net worth to regular old mom-and-pop, but also might include smaller hedge funds, small family offices, in some cases larger family offices.

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

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

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

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

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

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

So it was a self-sponsored, self-marketed offering. Elio did not choose to engage an underwriter or pursue any broker-dealer support in bringing their deal to market. And what was fascinating is they were able to generate a massive community of interested investors. And so, 6,300 investors all plunked down money, took their wallets out of their pockets, and responded to Elio's outreach on this offering. Interestingly, 60 percent of those that participated were already reservation holders for this vehicle. So they

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

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

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

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

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

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

So, if we advance here -- so about the time that Elio was completing its Reg A+ offering, W.R. Hambrecht was working with a company by the name of Hyperion. It's a biotech company. As our first Reg A offering, we sought to deliver to the market an offering that looked and felt as much like a traditional IPO as it could under Reg A. So we structured this transaction to reflect what looked like a conventional registered offering, so that it was an all-or-none type of structure with a price range. As you can see, the 3.1 million shares offered, so raising between approximately 25 -- or 20 and $30 million. And the express outcome there was to list those shares on the NASDAQ.

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

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

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

Yes?

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

MR. MALIN: That's correct.

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

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

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

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

case.

Any other questions?

(No response.)

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

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

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

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

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

And so, where we rely typically on a broad community of those independent broker-dealers to provide distribution to the retail community, they declined to participate here, so -- which left Hyperion, really, with only the crowd to drive investment in this offering. And that, unfortunately, never yielded the minimum of 15 million. So did not reach that minimum, could not have their first close, and didn't pursue the offering.

MR. YADLEY: Rob?

MR. MALIN: Yes?

MR. YADLEY: Do you have a view as to how much of that was -- that's what our process and guidelines require, in terms of NASDAQ or not -- binary -- and true concerns about liquidity. I mean was there a way to bridge that, moving to the non-NASDAQ NYSE bucket to another place, but still getting most of the advantages of a marketplace?

MR. MALIN: We hear the concerns regarding liquidity must less frequently than the concerns around a high degree of scrutiny in any involvement in unlisted securities. So, again, I think that's partly driven by the conservative nature of compliance officers at broker-dealers, but it's also perhaps driven by the fact that there hasn't been specific guidance provided by FINRA for those compliance officers to be able to follow a process for pursuing these.

So, we understand that, yes, often times people will be concerned that there won't be adequate liquidity for transactions like Allegiancy, where it was potentially going to be as large as a $30 million offering. I think liquidity concerns were less. But I can -- I do believe that that is a consideration. It

seems to be less a consideration on the individual broker side. So those individual brokers, quite frankly, are -- as I've said, are hungry for product. We'd like to present these opportunities to their clients, their investors.

MR. YADLEY: So, not to put words in your mouth, but a little more comfort from FINRA or the Commission that this is not imprudent to go into a non-NASDAQ/non-NYSE ecosystem.

MR. MALIN: Absolutely. I think that's exactly right.

CO-CHAIR GRAHAM: So are you suggesting that there seems to be -- that the greater issue seems to be compliance, and then -- and certainty with respect to compliance, as opposed to liquidity? And -- or is it -- does compliance because a greater issue because of the absence of liquidity?

MR. MALIN: I think, again, viewing it through the lens of a primary market offering, when we speak to dealers about distributing a new issue, it's typically a discussion around the compliance side and less about the liquidity.

So, certainly, liquidity will be a component that they consider. But if they believe that this is a quality investment, and they have investors -- and, in

many cases, those investors are people that might consider private offerings, and are less concerned around liquidity.

So, given that these brokers can communicate with investors that probably have a range of interest in liquidity, they believe that they can find appropriate homes for less liquid securities.

CO-CHAIR GRAHAM: And I'm guessing that it's like most things, one size doesn't fit all, and it's likely to depend on the character of the investors and the character of the company.

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

CO-CHAIR GRAHAM: Okay.

MR. MALIN: So we will continue on. Yet another case study here. And I -- again, I think it is important to run through a few of these, just because they all are different, and they all hopefully highlight some of the challenges and the issues that we faced.

So, coming off of Allegiancy, which, by the way, was a B-to-B company. And so, you know, despite their efforts to market that broadly, perhaps the appeal was somewhat less than it might be for a B-to-C company. And so, BeautyKind offered us that opportunity to test that. And what we saw here was a company that had strong retail recognition, had a very, very strong B-to-C

marketing component, particularly because they -- the way that BeautyKind works is you buy your high-end cosmetics, and those cosmetics companies then donate a portion of their profits to a charity of your choice. So very -- you know, certainly something that could energize a broad community of investors here, and again, you know, on a kind of a fan and enthusiast basis.

So, we designed this offering with that concern around meeting the minimum in mind. So designated a smaller minimum, a min-max offering of 5 to 10 million. And again, intended to quote those shares on the OTC QX. We did find a small number of our broker partners who were willing to participate. They did the work to go through the compliance to work on this offering. And what I would say the largest lesson from this effort was that, while we had very high hopes for the crowd participation, it proved highly unpredictable. So, unlike Elio, who was able to convert many of their interested crowd participants, BeautyKind did not see that same success.

Yes?

MR. REARDON: You don't have to answer this question if you don't want to. Is FINRA hostile to these deals?

(Laughter.)

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

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

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

MR. MALIN: Right.

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

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

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

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

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

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

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

MR. MALIN: Right.

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

MR. MALIN: Yeah.

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

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

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

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

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

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

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

So, when you say that, like, what guidance do you think FINRA needs to put out? Is it with respect to doing suitability on retail investors for, like, highly illiquid investments? Or is it more on diligence, suitability as an overall thing before they market or recommend? Or is it something else? I'd love to know, like, what you think would be particularly helpful.

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

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

MS. YAMANAKA: Yeah, I'm sure.

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

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

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

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

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

those companies.

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

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

CO-CHAIR GRAHAM: Right.

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

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

MR. MALIN: I think to a large --

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

MR. MALIN: That's exactly right.

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

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

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

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

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

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

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

MS. MOTT: Three years?

MR. MALIN: Less than four years.

MS. MOTT: Less than four years?

MR. MALIN: Yeah. In some cases --

MS. MOTT: Okay, so did they --

MR. MALIN: -- less than two.

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

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

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

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

MR. MALIN: Yeah, absolutely. And, as a matter of fact, it was something I was going to touch on, but I'm happy to do it now.

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

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

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

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

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

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

MR. MALIN: Right.

MS. MOTT: You know?

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

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

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

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

MR. MALIN: I think that's right.

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

MR. MALIN: Yeah --

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

sure we get to Brad.

MR. MALIN: Yeah, yeah.

CO-CHAIR GRAHAM: And so --

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

MR. EICHLER: Thank you very much, Chair, and thank you to the whole committee and Commissioner Stein, as well. My comments will be relatively brief. I've got a few slides put together, and it will be a little bit different perspective than what Rob laid out, maybe from a little bit higher level.

I want to go back to two comments that Chair Hanks made and Commissioner Stein made at the beginning. One was you got to have the right ecosystem in place. And the ecosystem that focuses on small cap stocks is under attack. And that's one of the things that I'll talk about in here today. And I think it's imperative, if we want to have an active market for small-cap stocks and small-cap IPOs, that you got to have people that are interested in those deals. That's point number one.

Point number two is a comment that Commissioner Stein made. Investment follows trust. We look at it as the IPO is just the first step in a life span with the company. It's getting them public, but then all the investors -- I mean the IPO, for us, is a time to bring together an issuer, which is a client of ours, and our institutional and retail clients of ours, and put those together in a transaction where everybody walks away and they feel like they got a good deal on the transaction.

And as we're often fond of saying, you know, the demand for stocks that go down is zero. And so we're highly incentivized to make sure we price a transaction correctly, make sure we trade the transaction post-deal,

and support that company so that the company is in a better spot one year, three years, five years down the road, and the investors that own that are in a better spot one year, three years, five years down the road. And so, that's kind of our high-level perspective. But I thought both those comments were very insightful, and directly relate to what I was going to say.

I've got no slides on Stephens. Just quickly, Stephens was founded in 1933 by the Stephens family. It's been owned by the Stephens family, continuously. We have one shareholder today, that's Warren Stephens. It's a very unique ownership model. We don't like and don't see how you could be a publicly-traded firm that's offering advice to people that doesn't correspond with quarterly results, and so we like the fact that we're private.

Our equity business began in 1970. Our second deal, we were fortunate enough to do a little retailer in Northwest Arkansas called WalMart. It was interesting, $4.95 million offering. At the time they had 30 stores, 30 million in sales, roughly. Of the 4.95 million, 1.5 million of it was selling shareholders. And it was a prospectus that was printed on small paper, and I think it was 24 pages long. So it was an interesting deal.

(Laughter.)

MR. EICHLER: And then, as Chair Hanks mentioned, I started off on the research side of the firm. I've been at Stephens for 26 years this July. Started off as a junior research analyst, research analyst, ran research, and have run banking for the last decade.

So, just to set the stage, you know, the number of public companies has declined by 50 percent when you go back over the last 20 years. Yeah, obviously, M&A plays a role in that, private transactions play a role in it, and company failures. But it's dramatic, when you look at what's happened over that time period.

When you look at IPO trends, the top chart here -- and, I'm sorry, it's a little bit hard to read from the back of the room, but the top chart shows the number of IPOs by year, going back to 1995 on the left-hand side to 2017 on the right.

One of the things I would point out is, you know, in that pre-2000 period we were averaging 400 deals a year, 400 IPOs a year. The average IPO size -- median IPO size -- was about $30 million. And now we're averaging, over the last -- since 2008, 130 deals a year, and the median deal size is $100 million, or slightly north of $100 million. And so, obviously, there is something that is not working right, and I will get into

some thoughts on that in just a second.

The bottom chart looks at IPOs for companies that have a $100 million or less market cap at time of deal. And, as you can see over -- since 2008 we've averaged 8.5 percent of deals are for, you know, true small-cap companies, whereas, you know, if you go back pre-2000, 30 to 50 percent of the deals were for that same size company.

You know, one of the factors to consider, you know, probably the biggest is the rise of private equity. Our business is diversified private -- M&A is a big portion of our corporate finance business. And, you know, private equity is a -- between private equity, venture cap firms, and family offices now, you're talking about trillions of dollars of spending power that are out just pursuing market -- pursuing companies aggressively, particularly companies that are highly attractive to go public. And with the amount of leverage that's available today, the -- these firms can go out and earn a very substantial rate of return by taking the company, levering it, and putting it in their portfolio, growing it, and then most of these firms prefer a clean exit on the back end, where they sell the company, as opposed to taking the company public. And so, that's one of the big drivers.

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

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

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

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

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

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

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

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

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

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

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

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

And so, Chair Graham, you were asking a question about demand. You know, there is not a demand for that product from our clients today. And when we look at the data on it, when you think about post-deal liquidity, when you think about research coverage post-deal, sponsorship, all those things, you know, where you've got somebody that's constantly trying to get the company out in front of new potential investors, the data is very limited. But what the data -- the limited data tells you is that that's been relatively unsuccessful.

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

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

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

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

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

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

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

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

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

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

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

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

And so, in the interest of time I didn't put slides in here, but if you look at the market share for the middle-market firms over the last decade, it's gone down materially every -- over that time period. And the reason why is because more of these underwritings are going to -- a disproportionate share are going to the larger firms that are lending money to these issuers.

And then, number three, under capital formation, JOBS Act has been great. I'm personally unsure of Reg A, and a lot of that is out of ignorance. But I think the continued efficiency and cost improvements are needed, anything that makes it cheaper to go to market and remain a public company.

That concludes my remarks, and I'm happy to answer any questions.

CO-CHAIR HANKS: Thanks, Brad. Actually, one of the things I'd like to talk about more -- because this has not been raised in this context -- is the tying issue, the idea that, you know, large institutions are sucking up business that the smaller broker-dealers might have been able to handle, and might have been able to use to foster capital formation by small companies. Can you talk a little bit more about that and how it affects you?

MR. EICHLER: Yes. You know, I'm going to give you two examples that just -- that I think will be

relevant. On an IPO for a sponsor-backed company, financial sponsors, the oxygen in their model is leverage. They have to have it on the front end to do a transaction. You know, all the deals they do are levered.

And so, when you look at the sponsor-backed deals, typically those are going to lenders that are providing -- you know, book-runner roles on those deals are going to lenders that are providing financing to those firms. Maybe not on that specific transaction, but transactions in general. And what's interesting about it is, you know, while the spreads on IPOs have -- they've come down a little bit, but they've remained relatively constant. What's changed dramatically is 10 years ago book runners, in aggregate, got about 45 percent of the economics on a deal, meaning 55 percent of it were going to the co-managers. Today, when you look at it, 85 percent of the economics are going to the book runners, and 85 percent of the -- and that's predominantly lenders on the business. So that's the IPO example.

The follow-on example that I would give you is we're increasingly seeing situations -- and again, without mentioning any companies' names, but increasingly seeing situations where we'll go to underwriting committee, and you'll have a whole list of people that

are providing research coverage to the company, and the underwriters that show up on the deal, a high percentage of them provide no ongoing sponsorship to the company. And it's hard to see where that is creating an environment or ecosystem that is helping promote coverage of and ongoing sponsorship of these small and mid-cap companies.

And, you know, we've looked at it, Chair, as well, where we've gone back and said, okay, what's the research follow-through? You know, on an IPO, if you look at middle-market firms, irrespective of where they are on the cover, just if they're on the cover three years later, how many of them still follow the name? And then we looked at bulge bracket and said, okay, for bulge bracket, if they're just the lead left, you know, how many of them follow the name three years later? And the difference is amazing. I mean, it's -- you know, you're talking 90 percentage point kind of plus follow-through versus 60 percent follow-through. And that's if you're the book runner on the deal.

And so, it's just one of those that, again, to have a successful small-cap ecosystem, you got to have people that care about it. And the big guys, I mean, that's just not -- that's not their business, just like our business isn't raising funding for Apple or Google or

anybody like that today. It's just a different strata of the market.

CO-CHAIR GRAHAM: Well, the ecosystem is something that we have focused on for some time, off and on. Just trying to understand what is real and what isn't. Certainly a post-deal sponsorship is important, and support from the standpoint of research, support from the standpoint of trading, that's all well and good. But how do you get there?

Is -- what do you see as some of the drivers? I mean you mentioned some of the regulations. I think we're all kind of -- we all kind of feel that a lot of the regulations that have been placed -- put in place over the last, you know, 10 years have contributed to the decline, recognizing there is some -- there might be some debate. But what about things like tick size, which we will turn to later on this morning? The fragmentation of the market? You know, coming up with an entirely new exchange? What do you see as some of the things that might be useful, in terms of driving additional support on the research side and the trading side?

MR. EICHLER: Chair, I think all the things you mentioned would all be helpful. I do think you have to unshackle the research analysts a little bit, and let them -- put them in a position where they can at least have a conversation with management about being a public company, what to expect, what investors are looking at, and what have you. I think that will make a big difference.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

MR. REARDON: I assume you know William Butler.

MR. EICHLER: Yes.

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

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

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

MR. EICHLER: That's correct.

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

MR. EICHLER: Well, he has been with two that have both gotten purchased. So I can't tell you the current one he's with, but --

MR. REARDON: He's done well.

MR. EICHLER: Yeah.

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

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

MR. REARDON: Institutional?

MR. EICHLER: Yes.

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

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

MR. REARDON: Well, either one.

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

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

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

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

MR. REARDON: Thank you.

MR. EICHLER: Yes, sir.

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

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

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

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

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

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

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

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

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

MR. MALIN: Agreed. Fortunately, I was not there at the time, so I didn't endure that pain that you're currently experiencing, but I understand that it was substantial. I'm clearly not, probably, the right person to answer that question.

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

CO-CHAIR HANKS: The second is equally painful.

(Laughter.)

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

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

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

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

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

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

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

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

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

MR. MALIN: I think it is, yeah.

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

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

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

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

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

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

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

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

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

CO-CHAIR GRAHAM: Please.

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

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

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

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

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

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

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

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

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

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

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

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investors.

MR. EICHLER: Well, I mean --

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

MR. EICHLER: Excuse me?

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

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

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

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

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

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

MR. EICHLER: That would be correct, yeah.

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

MR. EICHLER: Correct.

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

And it occurred to me, when we were talking

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

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

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

(Laughter.)

MR. YADLEY: Yeah, that.

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

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

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

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

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

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

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

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

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

So, again, if you determine you're going to attempt to engage institutions, once you've chosen a price that can be more challenging. No question. And that -- so it's not an insurmountable challenge, because you can structure these in different ways, and rely on that feedback. So we're talking to a company right now about what we'll call a hybrid offering, where they seek to have a longer, continuous capital-raising period from a broad community of investors. But we feel that they can do that most effectively if they have an initial investor -- hopefully, a sophisticated professional investor -- that expresses and opinion at the outset and invests money, perhaps enough to meet the minimum, at the beginning of that transaction. And then they can attract additional money.

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

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

(Laughter.)

MR. EICHLER: Thank you very much.

(Audio interference.)

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

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

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

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

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

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

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

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

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

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

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

So that's the pilot. I'm not sure -- we're about eight months in. The pilot data that is being collected is quite granular: order-by-order market-quality statistics. It also includes information on market-maker participation, profitability. That data was -- it's produced -- it's currently being collected. Baseline data was collected beginning six months prior to the introduction of the pilot, and will be collected six months after. Regulators have it now. It's not yet publicly available. The intent was to have it publicly available by now. But there are concerns, because it is so granular that it could actually reveal information about particular market-maker and trading center activities.

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

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

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

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

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

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

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

Some observers have said that they see more

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

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

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

Finally, there has been a shift in where trading takes place among the test group stocks. Almost all -- well, all three of the test groups have shifted away from maker-taker exchanges and more toward inverted exchanges. Groups one and two have shifted more to ATSs or dark venues. Group three, because of the trade-at requirement, has shifted away from dark venues, and we're seeing a lot more trading in lit venues for the group three names. And one of the other things we see with the group three names -- again, because of the trade-at requirement -- is an increased use of intermarket sweep orders.

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

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

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

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

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

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

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

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

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

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

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

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

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

CO-CHAIR GRAHAM: So, stay tuned, I guess.

(Laughter.)

CO-CHAIR GRAHAM: Is there -- I mean, recognizing, you know, where you are in terms of analysis and state of the study, and also understanding you -- can't hold you to anything, have you -- beginning to -- do you have any sense for what your conclusions might be? Do you have any sense for kind of a bottom line? Do you have a sense for whether this is even useful because it's something that's being done in isolation, and -- while nothing else that adversely affects the ecosystem is being done? Is this a little bit like treating a patient with multiple issues, and you just treat one issue and expect the patient to get well? You can --

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

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

Other questions, anyone?

(No response.)

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

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

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

A F T E R N O O N S E S S I O N

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

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

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

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

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

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

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

data-based.

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

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

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

So, NASAA is an organization of state regulators for those that don't know. We have the 51 jurisdictions, which includes D.C., a couple of other territories, and then we have the Canadian provinces, as well. This enforcement report focuses on the U.S. jurisdictions.

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

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

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

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

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

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

probably consistent with what people would expect.

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

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

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

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

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

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

The one thing that stood out to me was that, in terms of restitution, and in terms of penalties in 2015, there was a tick upward that was pretty significant. We had returned about $405 million to investors last year, and again the numbers this year are 538. So a significant increase, year over year.

Additionally, the number of fines and penalties that we were able to obtain were the highest since 2009, when they were about 245 million. So an increase there, in terms of restitution and penalties for investors.

CO-CHAIR HANKS: Michael, could I interrupt on that?

MR. PIECIAK: Yes.

CO-CHAIR HANKS: With respect to restitution, et cetera, is this actual dollars back in the pockets of investors, or dollars ordered to go back to investors? And do you keep those numbers separately?

MR. PIECIAK: Yeah, that's a great question. When we fill out this report, we do dollars back to investors. We often times will have the checks come to us and we relay them to the investors themselves, so we can be confident, you know, in our numbers. I can't say that every state does it the same way. But I think, on the whole, these numbers represent actual numbers and not sort of numbers on paper. Yeah.

CO-CHAIR GRAHAM: And what is your sense that -- I mean as to what these numbers say, from the standpoint of -- it seems like the numbers are going up. Does that -- do you feel that instances of fraud are

going up? Or do you just -- this is just more aggressive enforcement?

MR. PIECIAK: Well, I think if you look at the investigations and the enforcement actions, I mean, those consistently have been trending downward, and this year's report is consistent with last year's report. It's just that the restitution and the penalty numbers have gone up. So that could be an anomaly. We'll look at the data that comes in in September for this current or this past year.

But -- so based on the number of investigations and enforcement actions it wouldn't tell me that fraud is up. It would probably tell me that there were a number of cases that either were egregious or, you know, the -- or just larger in dollar -- total dollar number this year.

So the one last thing I want to point out in terms of the overall picture, and then we can go in and look a little bit more at the data from 2015. But the last piece that's also important that is somewhat licensing, somewhat enforcement, but the states also do a good job and have at the top of our importance agenda of gatekeeping who gets in to the industry and who remains in the industry.

So this last year, about 3,000 individuals had

applied for registration, withdrew their registration. I can't say that 90 or 100 percent of them were because they wouldn't have been registered, but a pretty large percentage of them would have had issues being registered in the jurisdictions where they're attempting to. And that number is pretty consistent with past reports.

Similarly, about 500 individuals were denied or suspended, or their registrations were somehow conditioned. And then 250 individuals were either revoked or barred from the industry all together. So again, another type of relief that state regulators look for, and the SEC, as well, in terms of protecting the capital markets and protecting retail investors, as well.

So, looking at the 2016 report, we also ask our jurisdictions what are the most cited products and schemes, in terms of the frauds that you see and the enforcement actions that you've taken. This year the top products, number one, were non-traded REITs. I think, in terms of products, number one, were non-traded REITs. And then oil and gas investment programs, annuity products, life settlements, viatical settlements. So that is pretty usual, those types of products we see often at the top of the list.

The one thing that stood out to me was that in the recent past, in 2014, '13, and '12, I think either

number 1 or number 2 in our products were 506 offerings, private-placement offerings -- and they didn't make the top list this year. I know they certainly are -- I know they are still -- we see a number of cases revolve in private placements and 506, but that was one thing that stood out to me was at least it didn't make the top 5 list this year.

In terms of types of schemes, nothing that probably surprises anybody. Ponzi schemes were number one. Internet frauds and definitely frauds. And there are some cases in the back that we can just sort of highlight about, some of the more egregious examples that we have seen related to those products and/or scams.

PARTICIPANT: Michael?

MR. PIECIAK: Yes?

PARTICIPANT: What's affinity fraud?

MR. PIECIAK: So --

PARTICIPANT: What's it -- what do you mean --

MR. PIECIAK: Yeah, so affinity fraud is, you know, in the most broad sort of definition, is when a fraudster takes advantage of victims based on some sort of connection or affinity that they have with the individual. So it could be based on going to the same church, or having your -- you know, being of the same ethnicity, or being in the same social group. So it's some sort of affinity that you have with the social circle.

And why they're so prevalent, I think, is because you break -- when you have that connection -- I mean Bernie Madoff was often thought of as an affinity fraud fraudster because he preyed on the Jewish community and, you know, he was Jewish himself, and that sort of created a sense of trustworthiness among his victims. So that's why affinity fraud is often at the top of the list. Yeah.

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

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

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

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

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

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

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

MR. PIECIAK: Yeah.

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

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

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

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

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

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

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

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

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

MR. PIECIAK: Of this?

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

MR. PIECIAK: Oh, the underlying results?

MS. YAMANAKA: Of the actual survey itself.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

In terms of working with other -- you know, other agencies, we certainly work as states, you know, collectively, particularly on things that are cross-border, which almost probably -- you know, a very high percentage of them would be. And then we also work closely with our federal counterparts, as well.

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

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

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

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

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

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

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

Yes, Catherine?

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

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

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

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

MS. MOTT: So more unregistered Internet --

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

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

MR. PIECIAK: Yeah.

MS. MOTT: And they didn't. And -- but people invested because they thought -- now, if they'd done their due diligence, they would have maybe -- they could see what we've invested in on our website, and things like that. But, you know, they didn't. They -- you know, so we were quite helpful with the prosecution on that. So --

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

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

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

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

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

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

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

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

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

(Laughter.)

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

that have the criminal jurisdiction. But those that do, you know, I know they use it judiciously, but they also get pretty strong results in very bad circumstances.

So, on the -- toward the end of the report there are some examples of case highlights from 2015 that I just want to touch upon, because I think they help illustrate some of the schemes and some of the trends that we've been talking about. And I don't want to go into great detail, but, you know, in terms of -- the first one is highlighting the -- some Ponzi scheme cases.

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

One thing that Virginia did this last year, which is to highlight that they went against the firm of a registered individual that was conducting a Ponzi scheme outside of his normal business operations, for failing to supervise that individual. So that's a sort of a new flavor as -- on to the traditional Ponzi scheme.

Relating to the Internet fraud that Catherine, you know, mentioned, this is one that we educate Vermonters about, but the so-called sweetheart, or romance scheme, you know --

PARTICIPANT: That's really affinity fraud.

MR. PIECIAK: Yeah.

(Laughter.)

MR. PIECIAK: Well, this particular case was a male that had, over a 10-year period, I think, had a high number of single women that he, you know, romanced over the Internet, and he got them to invest in a -- you know, an offering that he was conducting. And it was a fraud, and it, again, financed his lifestyle, and what not. But that's how we're seeing the use of the Internet more and more, both in terms of postings on Craigslist, and things of that nature, or the romance schemes, as people more and more look to online dating services to find -- you know, particularly those that are looking later in life. So those are issues that we're trying to educate the public about, as well.

Something else that we're seeing are the gatekeeper frauds. So these are probably most concerning. CPAs, estate planning attorneys. There is

examples of cases from 2015 that include them. Often times we think of the gatekeepers as our front-line staff to help us prevent abuse of elder victims or any victims. But when they themselves are perpetrating frauds, those are of serious consequence.

And then, of course, the senior frauds that we touched upon. And there is one example in here of a $13 million fraud in Minnesota that included 100 investors. Most of them were elderly or otherwise vulnerable, and a number of them had their entire life savings vanish from the fraud. And often times, when there are Ponzi schemes or Internet frauds or whatever, there is usually either not jurisdiction to get the money back, or there is no money to get back. So those are of particularly severe consequence.

So we will continue to, you know, look and regulate the local markets, retail investors, and also work as states, multi-jurisdictionally, to look at cases that have a greater impact. We're working on multi-jurisdictional, you know, plans to make it more efficient for us to bring cases as multiple state jurisdictions. And that's not an easy task, because states want to have their sovereignty, as well as help with each other. But you know, the states are working more cooperatively on cases that have a larger market

consequence, but are also there on the retail side to protect the retail investor.

So, with that, I think that's the highlights of the report, and happy to answer any other questions.

CO-CHAIR GRAHAM: Well, Mike, maybe I'm jet-lagged, and I just missed it, but one of the things that we're always wrestling with is balance, and balance between doing what we can to make capital formation easier, and then, of course, investor protection.

And I just -- I was just wondering about your take on the connection between level of regulation and fraud, and actual fraud prevention.

MR. PIECIAK: Yeah, and I think that's a good point, because, I mean, the two -- on the corporation finance side, when you're talking about regulation, I think you have to categorize them into trying to prevent outright fraud, which is kind of hard to do. I mean, regardless of what regime you have in place, or what the regulations are, you know, there -- what's the -- the old saying is that the bank robber doesn't wait in line at the teller's, you know, the teller line, or whatever. And I think that's probably consistent with securities fraud, that those that are going to commit outright fraud, it's hard to police them, other than to provide investor education, to ourselves be very vigilant for

things like free dinner, you know, planning events and free lunch planning events, and to keep our ear to the ground as to events that are happening in our own states. And then there is the other category of risk and what's the appropriate level of risk for investors, and that's a totally different conversation.

So I think, in terms of the outright fraud, I mean, it's hard to -- again, it's hard to regulate that in terms of preventing it. I think it's a multi-pronged approach. Education, state regulators have an active enforcement program. Investors, knowing who to turn to when they have a complaint. And then, in terms of striking the right balance of the other part of the equation, of the risk equation, you know, I think where -- I think both the SEC and states have been working diligently on trying to strike that right balance.

We have created programs in Vermont to help small businesses raise money. That doesn't mean that we're going to let the programs go and run without any oversight. We're going to continue to look, year over year, whether the individual businesses are raising money, whether they're doing the things that they said they were going to do, whether there are investor complaints.

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

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

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

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

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

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

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

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

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

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have to keep a close eye on and monitor.

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

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

(Laughter.)

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

MR. PIECIAK: Yeah.

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

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

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

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

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

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

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

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

(Laughter.)

MS. YAMANAKA: I mean --

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

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

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

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

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

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

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

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

MR. PIECIAK: Yeah.

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

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

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

CO-CHAIR GRAHAM: Okay. Any other questions?

(No response.)

CO-CHAIR GRAHAM: Thank you, Mike.

MR. PIECIAK: Yeah, my pleasure.

CO-CHAIR GRAHAM: Let's turn to our draft recommendations. The first one I want to pick up is the one concerning finders. And we've talked many times about the finders issue, urging the Commission to take steps to clarify the current ambiguity in broker-dealer regulation for intermediaries in private placements who identify or find potential investors.

The prior iteration of this committee made a recommendation on finders to the Commission in September of 2015. At our February meeting we have reiterated the importance of this issue to so many of us, and decided it was worth reiterating the recommendation. With a new chairman and new senior leadership coming in to the SEC, we wanted to do what we could to keep this issue from being overlooked.

I think everyone has a copy of the draft. I think everyone has a copy of our first round of comments, which came from Patrick. Does anyone -- is anyone not so armed?

(No response.)

CO-CHAIR GRAHAM: Okay. Any additional comments? I was going to ask you that, Patrick. Want to take us through your comments?

MR. REARDON: Yeah. The private placement -- there are a lot of names that get kicked around here, so I thought just the insertion of the term "private placement broker" or "brokers" would be helpful.

Paragraph four down there points out that there has been a little bit of action in the way of no-action letters. But I think it's worthwhile to point out that those are staff interpretations, rather than action of the Commission. And they are limited in scope, and there is no certainty -- less certainty that a court would be persuaded by them, since they're not action of the agency that's charged with administering the law.

And then the changes down in -- the recommendation in the first sentence are really my attempt to put a little more detail in there.

And then the most important change that I made was that in the first sentence I said, "Enact rules," and then I deleted the last sentence, which invited more regulatory action. Again, the reason being that that's not action by the Commission, and we've not had tremendous success with getting a lot of interpretive action.

So, those are my thoughts on why I made those recommendations.

CO-CHAIR GRAHAM: Okay. Well, frankly, it makes sense to me. As I recall, this is not inconsistent with the recommendation that we made a year or so ago.

MR. YADLEY: Yeah, that's correct. And notwithstanding that guidance would be useful, I think Pat makes a good point. And I'm -- I think enact rules rather than take action is a good suggestion.

CO-CHAIR GRAHAM: And does -- would it make sense to make specific reference to the prior recommendation, and expressly state that we are reiterating that recommendation, as opposed to in lieu of?

CO-CHAIR HANKS: It would if we're going to come out on the rule side. But could I just argue in favor of anything, any kind of certainty whatsoever, whether it's CDIs, whether it's FAQs, whether it's no-action letters, just something after 17 years? Because we -- I could see a rule-making which has to go through a very balanced process, you know, and it -- you know, you're talking about several months out there for any kind of rule-making process, where you're going to get a lot of arguing about what policy positions should be.

I mean we're not talking about anything in the next 18 months, except in some ideal world that we don't live in.

CO-CHAIR GRAHAM: Yeah, it seemed like -- as I recall, one of the things that was said before is that we wanted to see the Commission do just what you said, do something, and not necessarily wait until the perfect rule was in place. And I think that that sentiment should be reflected in this, as well.

MR. GOMEZ: Steve, just to -- sorry, just to answer specifically your question, the previous recommendation from this committee was broader in the sense of detail. So one thing to your question to consider is if you are limiting what the recommendation is here to just enactment of rules, but then at the same time you're also re-adopting the previous recommendation, are you limiting to just enacting rules, or are you also recommending everything else that was recommended in that other recommendation, some of which might have been done without doing rules, in the sense that -- are you re-adopting a recommendation that was broader than how Patrick narrowed it here? And, if so, which one is it?

So just something for you guys to consider. I mean, at the end of the day, it's your recommendation.

PARTICIPANT: And that's sort of the -- and I actually had written down "enact rules or provide guidance." But --

CO-CHAIR HANKS: You could say "preferably."

PARTICIPANT: Yeah. Sebastian is right. And we've actually made recommendations on two different occasions, and we hearkened back to the task force and the recommendations of the forum on small business capital formation, many of which were very specific, in terms -- included things such as amounts and types of transactions.

We're trying to be forceful. And I'm -- take action was great. You convinced me. I could easily sway the other way. The point is we do want to do something. It says in the near future, and I'm not aware that the Commission is ever -- although "ever" is a strong term -- just come out of nowhere and said something. There's been thoughtful staff discussion, there's been proposals, or there has been an imperative from Capitol Hill. But I think the force of our recommendation is more important than whether we compromise on -- rather have guidance if you'll do it right now, but rules would be better because it would be more comprehensive. And trust the staff and the new full Commission to say, okay, we agree it's important, and have more dialogue.

But I think everybody's views on this one are important, because it is such a key issue.

CO-CHAIR GRAHAM: Yeah. I take your point. And I think that makes sense. We certainly don't want interim guidance to be a substitute for rules that essentially fix the issue.

CO-CHAIR HANKS: And if I could interject, also not a concept release, which is sort of like a -- we see that happen. Sorry.

(Laughter.)

CO-CHAIR HANKS: Nothing interim, nothing concept. Actual guidance.

CO-CHAIR GRAHAM: Okay.

PARTICIPANT: How would we wordsmith that so that we --

CO-CHAIR HANKS: "Please do not issue a concept release."

(Laughter.)

CO-CHAIR HANKS: I mean in plain English.

PARTICIPANT: I don't know. Okay.

CO-CHAIR GRAHAM: You could say, "enact rules or provide definitive guidance in the near future," but it does say provide regulatory certainty.

CO-CHAIR HANKS: I mean that's what we're aiming for, is that certainty issue.

CO-CHAIR GRAHAM: So I think, as long as we're recommending -- if we enact -- in the near term we're recommending that we enact rules and that we provide guidance, all in the effort to address this uncertainty, that's said what we wanted to say, haven't we?

MS. YAMANAKA: Can I ask a question about this? Because I didn't have any orientation to this until I came to the meeting. And clearly, it's been ongoing. What struck me and what pushed me over the edge was the 17 years. Right? I mean 17 years? Marriages last less than that time. So -- not mine, though.

But I think that's -- when you read this, it sounds like, okay -- it just doesn't sound as strong as when you're going there's been no movement on this for 17 years. So I'm kind of with Sara in the sense that if you don't want to do it, then you have to make a stand and say, "We're not going to do it," as opposed to making the request and making it sound polite. And again, if I just read it as is, it just sounds kind of -- a little bit testy, but not over the edge. But, I mean, 17 years? What does it take?

So I just put that out for the group because -- you know, and I know we're in a different administration, so maybe that makes a difference. But the past 17 years

we've covered a lot on both sides. So I'd just like to know why. Why isn't there a position taken? Or to just come back and say, "We aren't going to do this," and then we can decide what we want to do.

CO-CHAIR GRAHAM: Well, it seems to me that -- I mean I don't know how much -- I mean I think that we're sufficiently direct by stating that, look, nothing has been done for a while, we want you to take action. I don't think that that's impolite. And I don't think it's being overly polite.

MS. YAMANAKA: I defer to the group. It's just that, to me, the 17 years was instrumental in my pushing forward to staff. That's all.

CO-CHAIR GRAHAM: Okay. Annemarie?

MS. TIERNEY: I wouldn't mind seeing that in here.

CO-CHAIR GRAHAM: Seventeen years?

MS. TIERNEY: Yeah.

CO-CHAIR HANKS: Is it not?

MS. TIERNEY: It's not here.

CO-CHAIR HANKS: Well, repeated -- longstanding, 17 years?

MS. TIERNEY: Whatever it is. Whatever it is. I mean that's a pretty -- we all know this is an issue in the space. We in the state see this as an issue. We know it's an issue.

CO-CHAIR GRAHAM: Is it -- Julie and Sebastian, do you know whether that number is correct?

MR. GOMEZ: Yeah, it is, 2005 was the ABA task force report. Also, there was a small business advisory committee that, in their final recommendations of April -- it was either 2007 or 2008, but I can't remember which -- urged the Commission to adopt the principles in the 2005 ABA task force --

MS. DAVIS: So -- and forgive me because I'm not as familiar with the history on this one -- but is it -- 2005 is the earliest that --

MR. GOMEZ: No, no, that was --

MS. DAVIS: I know it's been raised for a long time. But maybe you want to cite a document that has a year.

MR. GOMEZ: Well, the 2005 ABA report. The 2006 SEC advisory committee and small business forms for -- we can go back as long as we want.

MR. REARDON: Since dinosaurs roamed the earth.

CO-CHAIR GRAHAM: So you -- the earliest data I heard is 2005.

MS. DAVIS: So the ABA task force caught it by saying it had been a problem before, right? So you're --

MR. REARDON: In the last century.

(Laughter.)

MS. DAVIS: So I would like to see that kind of background, because I think that adds fuel to why the tone of this is action-oriented. It's a problem in the market. And I like the paragraph that, you know, we're disappointed. I was disappointed in Steve Luparello's testimony to us on the topic. He seemed like he just kind of shrugged it off and said, "Well, we do enforcement where we do enforcement," and that felt very unsatisfactory.

So I think something strong from the committee is warranted, based on the history, the length of time, and kind of trading in markets idea that, you know, well, we do take enforcement every now and then. I wouldn't mind seeing us say something like we want the Commission to, you know, enact rules and, in the meantime, while those rules are pending, you know, issue guidance that provides certainty in the short term over the long-term rule-making process, if we can ask them to do that.

CO-CHAIR GRAHAM: I think all those are good ideas. Essentially, we're, you know, tying back to the 2005 document. And so -- with respect to we want to see some rules. But in the meantime, let's do what we can to --

MS. TIERNEY: And I don't know what the last

recommendation was, Stephen. So I don't know -- when you're saying it was more specific, Sebastian, like, were there actual things that we said the rules should include?

MS. DAVIS: Yeah, it's pretty long. I can read it to you, if you want, or -- I mean, well, first of all, in the 15, 12 -- in the number of years it cites the ABA task force in 2005, and as recognized by this advisory committee and the small business forum since 2006, and it documents the things that were documented in those reports. So you could cite to that, if you wanted, on the timing.

And then there were four recommendations. The Commission takes steps to clarify the current ambiguity in broker-dealer regulation by determining that persons that received transaction-based compensation solely for providing names of or introductions to prospective investors are not subject to registration as a broker under the Exchange Act. And there's three others. I will only read them if folks want to hear them.

CO-CHAIR GRAHAM: All consistent with what is currently on the table.

MS. DAVIS: Certainly not inconsistent. I mean it does say -- the last one says, "The Commission should take immediate intermediary steps to begin to address

issues regarding the regulation of intermediaries in small business capital formation transactions incrementally, instead of waiting until development of a comprehensive solution."

CO-CHAIR GRAHAM: Right. When was that?

MS. DAVIS: That was 2015. So --

CO-CHAIR GRAHAM: 2015. And there was one before that?

MR. GOMEZ: Yes, there was, the one before that was not as --

MS. DAVIS: 2006.

MR. GOMEZ: -- as detailed as this one.

PARTICIPANT: This committee. I think we were more polite the first time, and urging that the Commission lead the effort, along with NASAA and FINRA. Yeah.

MR. REARDON: We could just repeat that.

CO-CHAIR HANKS: Well, we're referencing it, right, in the --

MR. YADLEY: So part of the question, I think, is -- there is a lot out there. And I think I wrote a paper for this committee in July a year ago. So the question is do we want to be succinct and say, "Hey, look, it's been X years. You should enact rules and provide whatever guidance in the short term without waiting for promulgation of the rules to do that," and leave it at that, or do we want to get chief consensus on things, some of which we already did, and be more detailed?

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

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

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

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

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

MS. DAVIS: And underline "now" three times.

(Laughter.)

CO-CHAIR GRAHAM: All caps?

MS. DAVIS: All caps, larger font.

(Laughter.)

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

CO-CHAIR GRAHAM: That strikes me as sufficient.

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

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

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

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

MR. REARDON: Yeah --

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

(Laughter.)

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

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

MS. DAVIS: Yeah.

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

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

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

MS. DAVIS: Okay. So that stays?

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

MS. DAVIS: Okay.

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

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

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

CO-CHAIR GRAHAM: Yes.

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

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

MS. DAVIS: You do want that.

CO-CHAIR GRAHAM: Yeah.

MS. DAVIS: Okay.

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

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

CO-CHAIR GRAHAM: What I would suggest is that, once there is some consensus, and we appear to be -- to have achieved consensus, that we draft something and then re-circulate it to the group. Make sense?

MS. TIERNEY: Can we ask for -- so which -- would this be directed to the division of training and markets?

MS. DAVIS: All the recommendations have historically been directed to the chairman of the Commission.

MS. TIERNEY: No, but the call for action. Would that be -- that would be rule-making? That would be --

MS. DAVIS: This would definitely be something done out of trading and markets, if it's rule-making, and -- or guidance.

MS. TIERNEY: Can we ask for a report back on the status? Maybe, like, the next six months or --

MS. DAVIS: Well, keep in mind that your term ends in September of the Committee. So there is one more meeting, unless we do a telephone meeting, which is certainly doable.

MR. REARDON: We'll be out of her hair soon.

(Laughter.)

MS. DAVIS: Yeah, but there will be new ones of you. Just kidding. So you know, just keep that in mind, in terms of it's going to be different people. I mean

that's way above my pay grade, but --

CO-CHAIR GRAHAM: I think we can always ask for that, it seems to me.

MR. REARDON: This is not serious, but if you want a moment of levity, we could always put up here in the title, 3.b.3.0.

(Laughter.)

CO-CHAIR GRAHAM: Okay. Do we feel that we're in a position to pass this recommendation today, or do you want to see it -- do you want to see a redraft?

PARTICIPANT: I trust the chairs to put our thoughts in writing, so that we avoid delay.

CO-CHAIR GRAHAM: Okay. In that case, could I have a motion that we adopt the recommendation, as amended?

MR. YADLEY: So moved.

MS. MOTT: Second.

CO-CHAIR GRAHAM: Okay.

All those in favor?

(Chorus of ayes.)

All those opposed?

So now it's on to our recommendation on secondary market liquidity. And during the February meeting we also discussed the problem of limited liquidity in secondary markets for holders of shares in

smaller companies. We focused in particular on companies that are providing semi-annual reports, following a regulation A, T, or 2 offering.

Availability of these ongoing updates means there is information available to help establish pricing and transparency in the secondary market. Yet investors in Reg A securities are likely to have a difficult time when they are ready to sell their shares, with one key reason being that they have to find state exemptions for each trade.

We discussed that this is an area where it makes sense for the Commission to consider using its Section 18 preemption authority. Nothing that the majority of states already have exemptions for these secondary trades, we agreed that the Commission should collaborate with NASAA in this area. Again, I think you all have a copy. Once again, Patrick provided comments. And I would ask that Patrick walk us through his comments to get started.

MR. REARDON: One, in paragraph two, the sentence added at the end. It may not be the greatest literary sentence ever written, but the thought is that illiquidity has a discount on value. And we did discuss that, because I remember mentioning it. I think that's worth noting.

CO-CHAIR GRAHAM: I'm sorry, what did -- what's --

MR. REARDON: The sentence added at the end of paragraph two. Also, the securities lacking in available market generally bear an illiquidity discount on value.

CO-CHAIR GRAHAM: Okay.

MR. REARDON: The third paragraph that I added is the result of my reading this entire recommendation, and saying we want there to be some sort of exchange here, but never really saying how it would operate. And my thought was -- and I don't know how to operate it. So I went looking for something that -- somebody said a little bit something about how to operate it. And I found this from a speech that Dan Gallagher gave in 2014 that has a little bit about it, so I thought it really, I hope, strengthens the recommendation, because it indicates we at least have given some thought to how such an exchange might operate. He is using the term "venture exchanges," which I'm willing -- happy to adopt. But it's really only intended to make the recommendation appear well thought out.

And then the last bullet on number four on page three is from Michael. I think that's important for them to know, that we're not trying to stifle state regulators' anti-fraud jurisdiction. And if there is fraud in connection with all of this, that -- this trading -- that certainly nothing here is intended to step in the way of their going after the miscreants.

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

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

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

CO-CHAIR GRAHAM: Okay.

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

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

I hesitate to bring venture exchanges into the

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

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

Annemarie?

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

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

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

CO-CHAIR GRAHAM: Okay, fair enough.

MR. REARDON: Take that out.

CO-CHAIR GRAHAM: Okay.

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

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

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

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

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

CO-CHAIR GRAHAM: Yeah, yeah.

MS. TIERNEY: Yeah, I agree with that.

CO-CHAIR GRAHAM: Okay. Other comments?

(No response.)

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

MS. TIERNEY: So moved.

MS. MOTT: Second.

CO-CHAIR GRAHAM: All those in favor?

(Chorus of ayes.)

CO-CHAIR GRAHAM: Opposed?

(No response.)

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

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

(Laughter.)

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

CO-CHAIR GRAHAM: As I think Julie mentioned a moment ago, the September meeting is scheduled to be our last meeting, unless we have a telephonic meeting along the way. It may be difficult at this time, within the time allowed, to come up with some additional meaningful recommendations. And so one of the things that we're thinking about is that we should all put our heads together and think about the letter that we should leave behind for the next iteration of this committee, and note the things that might come under the heading of unfinished business.

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

Okay, yes?

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

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

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

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

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

MS. DAVIS: I think that's right.

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

(Laughter.)

CO-CHAIR GRAHAM: Okay. Anything else?

(No response.)

CO-CHAIR GRAHAM: All right. Safe travels.

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

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PROOFREADER'S CERTIFICATE

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

File Number: OS-0510

Date: Wednesday, May 10, 2017

Location: Washington, D.C.

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